United States Court of Appeals

for the Second Circuit

EXHIBITS

Docket No. 74-2108

IN THE

United States Court of Appeals

For the Second Circuit

UNITED STATES OF AMERICA,

Appellee,

—*v.*—

THOMAS M. FAHEY,

Appellant.

On Appeal From the Judgment of the United States District Court for the Northern District of New York

---

RECORD ON APPEAL (3 Vols.)
(Vol. III — Page 499 to End.)
TRIAL BRIEF and other items of the Record

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** Indicates the papers submitted to U.S. Attorney on 5/30/74.

The physical form of the trial brief was 7 small, loose-leaf volumes (Groups A through H). It was organized in this manner to best gather and present the information we were submitting to the U.S. Attorney to support dismissal before trial. For ease of appellate reference, we have collected the material into one volume together with all other items of the record, exclusive of the transcripts (separate volume) and the trial exhibits (separate volume).

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Memorandum on "The Case for Dismissal"
(Trial brief, 5-30-74 — Exhibit H-1).

Re: United States v. Thomas M. Fahey
CR No. 73 CR 181
Indictment: Violation 28 U.S.C. §7201

The Case for Dismissal

MEMORANDUM OF LAW AND PROCEDURE

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Memorandum on "The Case for Dismissal"
(Trial brief, 5-30-74 — Exhibit H-1).

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THE CASE FOR DISMISSAL

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Memorandum on "The Case for Dismissal
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THE CASE FOR DISMISSAL

Memorandum of Law and Procedure

In the spirit of the cooperative exchange of evidence and information that has existed between the United States Attorney and the defense counsel in this case, I am submitting in this memorandum more than would ordinarily be contained in a normal memorandum of law.

Before the indictment was handed down, I knew nothing about the taxpayer's involvement with the IRS in this personal tax problem, even though I was on retainer to the client for legal assistance pertaining to his business. I was therefore familiar with the details of his partnership dispute to which the tax problem is directly related.

From the basic elements of information the taxpayer initially gave me relating to the circumstances of the tax problem, I found it difficult to understand how this case reached the indictment stage.

Consequently, I embarked on a thorough and complete investigation and analysis of all the facts and law involved in the tax aspects of the situation.

In so doing, I found there were significant procedural aspects in this case, with respect to which I have had a very strong reaction and have accordingly included herein a very frank analysis which I hope the U.S. Attorney will find helpful in evaluating the case for dismissal.

I

DETAILED ANALYSIS OF HOW THE INADEQUACY OF THE INVESTIGATION RESULTED IN AN UNJUSTIFIABLE AND UNSUPPORTABLE INDICTMENT

This is one of the most extraordinary cases in criminal tax law that I have encountered in the 13 years in which I have been involved in handling tax cases, both as a former US attorney for the Northern District and as a practicing attorney.

What makes this case so extraordinary is that it is a unique example of how the complete failure of an IRS Special Agent to fulfill the high standards of investigative thoroughness and fairness required by tax evasion cases can result in an unjustifiable and unsupportable indictment.

What makes it hard to believe this happened is that the taxpayer offered absolutely no resistance to the investigation of his personal or business matters and also voluntarily disclosed the sources and leads for all other information pertaining to the subject of the investigation.

This kind of thing is not supposed to happen. But the fact that it did happen shows the great importance of the high standards of investigative thoroughness imposed by both the Department of Justice and by the Federal courts on the activities of Federal agents investigating taxpayers for possible tax evasion.

There is something very special about tax evasion cases that requires special investigatory thoroughness. At the risk of seeming pedantic, I will review the reason for this requirement because it is directly material to this case.

It is a well-known and long-established policy of the Department of Justice that the prosecution of tax evasion involves a strong element of deterrence - to show that tax evasion is wrong and that it does not pay.

Because of the deterrent element, it is extremely important for the government not to lose tax evasion cases.

What this means for the Department of Justice is that it must have in its possession all the pertinent evidence in the case so that a decision can be made by the Department as to whether all the evidence will prove the taxpayer is guilty, beyond a reasonable doubt, of income tax evasion. This guilt must extend to both:

(1) the certainty of the tax involved, and

(2) the intent of the taxpayer to evade.

If the Department of Justice does not have all the pertinent and relevant information regarding both of the above elements in the case, it is running the risk of a trial that produces surprise, embarrassment, and defeat for the government - and consequently a blow to the deterrent policy.

The need for maximum information and certainty on the part of the Justice Department now imposes upon the IRS an equal obligation to uncover and provide the maximum amount of information possible, so the Justice Department can properly evaluate the case.

To provide maximum information requires meeting a very high standard of investigative thoroughness. Special Agents cannot afford to do a sloppy or incomplete job of investigating, --- otherwise they endanger the entire process.

Nor can Special Agents make "pre-judgments" of their own either before or during an investigation. This, I believe, is the cardinal sin against investigative integrity.

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When this happens, the Special Agent no longer gathers "information", per se, regardless of whether it points to the guilt or innocence of the taxpayer. He begins to see "facts" through a judgment filter. And he will mislead himself as to what is "relevant" to his investigation and what is not.

He may then even stop far short of the extent to which he should go for maximum thoroughness, thinking he has found "enough" to satisfy his own pre-judgment --- whether it be "guilty" or "innocent".

And in the worst possible situation, if he has personally "pre-judged" a taxpayer to be "guilty" within the scope of his own limited knowledge, he may not only limit the scope of his investigation, but he may also "build" so-called "evidence" that is either irrelevant or contrary to other facts he does not know about, and but for his pre-judgment, should know about --- all of this would ultimately be revealed for what it is at a trial --- to the great disadvantage of both the taxpayer and the government.

This last situation, sadly enough, is what happened in this case.

What I am saying is that, in this case, all the investigative information shows clearly that the Special Agent had pre-judged the taxpayer right from the very outset of the investigation, (on the basis of the most meager information), and the consequence was a complete failure to fulfill the high standards of investigative thoroughness he should have followed.

The inadequacy of the investigation included four major types of deficiencies:

(1) Incomplete in scope - did not uncover material facts in the case that were readily available.

(2) Incomplete in depth - did not check the legal and accounting significance of the facts he did have in his possession.

(3) Technical error - obtained affidavits that were not relevant as "evidence".

(4) Error bordering on "impropriety" - obtained one affidavit that was false on its face.

These specific deficiencies will be discussed throughout the remainder of this memorandum.

There is also an element of basic procedural "unfairness" in this case that stems from the manner in which the investigation was stimulated, and in my opinion, is not in accordance with the general standards of fairness prescribed by the Federal courts for Federal investigative agencies.

The investigation of the taxpayer originated in the criminal division of the IRS at the urging of someone acting for the partner against whom the taxpayer was engaged in litigation. During the subsequent investigation, the Special Agent had numerous contacts with one of the attorneys for the partner in the litigation. The Agent did not have any corresponding contacts whatsoever with the attorney for the taxpayer in the litigation.

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This kind of relationship shows very clearly that the pre-judgment of the Special Agent kept him from doing what any fair-minded and open-minded investigator would do.

Here, the Special Agent was in a situation where the person suggesting a criminal investigation of a taxpayer stood to derive a direct benefit himself from the very existence of the investigation, regardless of whether the taxpayer was ultimately cleared of suspicion or not.

Under these circumstances, there is an obvious duty imposed upon the Special Agent not only to investigate the case, but to do so with even more care and thoroughness than is usual, and with a healthy skepticism about what he is "told" by the instigator, to avoid having the criminal arm of government being unfairly and improperly "used" as an ally for one side of a private economic fight between two partners.

In this situation, having conferred with an attorney for one side, fairness and objectivity would absolutely demand that the Special Agent also confer with the attorney for the other side, not only as a way of getting <u>all</u> the significant facts, but also to safeguard against the possibility that there were legal involvements in the case that might be complex or not readily apparent on the surface.

However, this did not happen at all. Instead, the relationship of the Special Agent with the "instigator" obviously became a part of the process of "pre-judgment" by the Special Agent.

This process of pre-judgment by the Special Agent is directly traceable to one basic cause --- the lack of awareness and understanding of the complexities of partnership accounting law.

The Special Agent was therefore unable to understand the material significance of the various aspects of the partnership dispute and its relationship to the problems involved in characterizing and determining a particular partner's net income --- especially when the whole complex method of computation and division of income was in dispute.

This lack of understanding is clearly evident not only from the actions of the Special Agent, but also from the memoranda he wrote reporting the conversations between himself and the taxpayer.

Neither the Special Agent nor [illegible] axpayer really knew the full legal and accounting significance of what they were talking about when they used the terms "depreciation", "losses", "draw", "agreements", etc.

The taxpayer, on his part, was trying inartfully to explain the factual elements, whose legal and accounting significance coul[illegible]ve been explained properly at this stage by a qualified tax attorney and/or a skilled professional accountant.

So they both got themselves into hot water by getting in deeper than they should have without the benefit of knowledgeable professional counsel, who would have spotted the real basic problem between them --- lack of meaningful communication.

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By not fully understanding the situation, the Special Agent formed his pre-judgment and then went out and rounded up affidavits from the other partners which merely documented one side of the dispute that was going on between the partners, this hardly constituted any kind of "evidence" at all.

To make matters worse, one of the affidavits obtained by the Special Agent from one of the partners was actually false on its face regarding an important, and a very obvious, fact in the case that was directly material to the taxpayer's position. This affidavit was later modified to some extent but its existence would be very embarrassing the the government. One thing about these affidavits is very clear and very serious --- they raise open questions about the competence of the Special Agent.

Since there was no evidence in the case to show "intent to evade" on the part of the taxpayer, the Special Agent was clearly trying to manufacture that evidence, based on his own misconceptions of the case.

By thus concentrating on creating "evidence" of his own, the Special Agent thereby missed one of the most important single pieces of concrete, positive evidence (and also the most readily available) in the entire case. That evidence was the letter of instruction from the accounting firm of Ernst & Ernst to the taxpayer (and to each of the partners) specifically identifying which items on the U.S. Partnership Return should be transferred by each partner to his personal return. (These letters, which I shall discuss later, omit any reference to the amounts in question.)

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What is procedurally amazing about this, is that the Special Agent actually did visit Ernst & Ernst early in the investigation. But when he was there, all he asked for was the record of cash disbursements. He did not ask to see the Ernst & Ernst copies of the U.S. Partnership Returns and all the instructions that were related to them. Nor did he ask to see the "work papers" of the accountants.

All he wanted to do was verify that the dollar amounts that were entered on the U. S. Partnership Return were actually physically received by the taxpayer. He was not interested in delving into its "characterization".

The only way this fatal investigative oversight can be explained is that the Special Agent had already pre-judged and decided what was "relevant" and what was "enough" evidence. --- If you have what you think you "need", why ask for anything more?

When I first received this case, after the indictment had been issued, it was clear to me from some of the basic evidence I had seen and was aware of, that the case should never have reached the indictment stage --- but I was not quite sure how it could have happened.

Now, after discovering and analyzing all the investigative deficiencies in the case, I can understand how the case went all the way through the administrative process and through the indictment stage.

What everyone assumed to be "evidence" was not evidence at all. Whatever they did have "seemed" to be probative of the charge. They had no evidence at all that would negate the charge.

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Now that the entire case has been properly and completely investigated and analyzed, we have the following new conditions of evidence.

A. With respect to supporting the charge of tax evasion: The government has no direct evidence to support the charge of intent to evade.

B. With respect to negating the charge of tax evasion: There is an abundance of new evidence and information (both factual and legal) which negates both of the elements that must be proved beyond a reasonable doubt to obtain a tax evasion conviction, namely:

(1) The certainty of the tax involved, and

(2) The intent of the taxpayer to evade.

The remainder of this memorandum sets forth the taxpayer's specific lines of defense that completely refute the charge of tax evasion.

II

THE TAXPAYER HAS SEVERAL LINES OF DEFENSE -- ANY ONE OF WHICH IS SUFFICIENT TO REFUTE THE CHARGE OF EVASION.

The taxpayer has several lines of defense. Each one of these defenses is sufficient, in itself, to refute the charge of tax evasion.

All of the defenses refute one of the government's elements of proof -- the intent to evade. Some of the defenses refute both of the elements of proof -- the intent to evade, and the certainty of the tax.

Before discussing the specific lines of defense, I think it is important to point out one of the basic elements of the case that was never clearly identified during the investigation.

What I am referring to is the true nature and scope of the "taxable income" question in this case.

The true "taxable income" question involving the taxpayer in this case is not limited to the years 1966 and 1967. The real tax question is to establish what the "taxable income", if any, really is for the years in the entire continuous period he was a partner at the Castle Rest Nursing Home -- namely 1965, 1966, 1967, 1968, 1969 and 1970 -- and not for only the selected years of 1966 and 1967.

The reason the scope of the tax question extends this far is because of the nature of the dispute between the taxpayer and his

partner and because of the complexities of partnership accounting law.

From shortly after the start of the partnership, there was a running dispute between the taxpayer and his partner over the key factors affecting the computation and division of partnership income. The one-sided allocation of "depreciation" and "losses" that was "forced" into the last of three agreements by the taxpayer's partner in 1965 was very important in the controversy. The disputes finally erupted into litigation, in which the opposite positions that were taken affected all the "draws", "net income", and "capital accounts" of the partners from the start of the partnership, whose first full year was 1965.

The litigation lasted over three years (from June 1969 to October 1972). The litigation was ended on October 19, 1972, on which date the taxpayer purchased the entire nursing home business from his former partner, and they both agreed to end the litigation as a condition of the purchase and sale.

The manner in which the litigation ended - by purchase and sale of the property rather than by court resolution of all the issues affecting the calculation of net income -- still preserved for the taxpayer the right to assert, for income tax purposes, all the arguments against the accounting methods used that were contrary to IRS regulations regarding "depreciation", "losses", "draws", etc.

After the litigation was ended, the taxpayer could then sit down with the civil side of the IRS and go over the whole question of what his income tax liability really was for the entire period from 1965 through 1970.

Instead, he was prematurely prevented from doing so by being backed into a "defense" of only the "selected" years, 1966 and 1967, by a "suspect" criminal investigation. A taxpayer is not permitted to resolve the civil part of the tax question until a criminal investigation or action is disposed of. This created still another procedural unfairness for the taxpayer. He has been in this state of "suspension" from the time the initial investigation was started (July 1970); and to this day, no one from the IRS civil side has ever presented the taxpayer with any bill, assessment, or statement of any kind saying how much the IRS thinks he owes and asking for payment. Instead, he was charged with tax evasion with no evidence of intent and with manufactured "evidence" that is completely irrelevant to the charge.

I will now discuss all of the taxpayer's specific lines of defense which completely refute the charge.

A. The first line of defense is that the taxpayer followed and relied upon the accounting firm's letter of instructions that accompanied the U.S. Partnership Returns.

This defense completely refutes the intent portion of the charge.

There are two basic questions involved in this defense:

(1) Did the taxpayer, in fact, adhere to the instructions precisely.

(2) Did the taxpayer satisfy the ancillary requirements of the "reliance" or "advice-of-counsel" defense (such as full disclosure to the accountants) that permit him to use this as an absolute defense that proves lack of intent.

The law is very clear on this point.[1] The taxpayer has an absolute right to rely on the instructions of the professional accountants.

The basic qualification to the rule is that the taxpayer himself must make full disclosure of information to the accountants who prepare the returns. He must also follow the advice he receives without departing from it.

In this case, the taxpayer received from the accounting firm letters of specific instructions specifying to the taxpayer, and to each of his partners individually, precisely what information was to be transferred from the Partnership Return to the Individual Return.[2]

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[1] See Exhibit G-6, Case Law on the "Advice-of-Counsel" Defense, Prepared by Defense Counsel.

[2] See Exhibits F-1, F-2, and F-3, Letters of Instruction from Ernst & Ernst.

These instructions specifically singled out the entries in Schedule K, Column 6, "Ordinary Income (Loss)" to be transferred to each individual partner's personal return. These were the only instructions for transferring figures from the partnership return to the individual returns, in both years, 1966 and 1967, and they were very specific.

"....Each partner should include in his 19____ U.S. Individual Income Tax Return the amounts shown opposite his name in Schedule K, Column 4...."

In 1967, they also singled out another item in the Partnership Returns (lines 3(ii) and 3 (iii) of Schedule K), which they said they were calling to the partners' attention because these items involved computation of investment credit.

When all the partners read their instructions, and went directly to Schedule K, Column 6, to find what was there, they would find an entry for partners McKinney and Simpson, and no entries for partner Metzger or the taxpayer.

The taxpayer, finding no entry opposite his name, was not obligated to do anything else but follow the instructions and make no entry on his personal return.

The accounting complexities in partnership accounting and partnership law are almost unbelievable. No uninformed layman, such as the taxpayer, can possibly be expected to do anything more than pay professional accountants to do the work and hope they do it right.

When Ernst & Ernst was first engaged in 1966, they found the bookkeeper had been withholding State and Federal taxes from the money drawn by the taxpayer, in accordance with specific instructions to do so from a prior accounting firm. When Ernst & Ernst discovered this, they instructed the taxpayer to stop the withholding, which he did, again following instructions from the accountants.

This is a clear example that shows the taxpayer's basic conduct of relying on, and strictly following, the instructions of professional accountants paid to provide these instructions in matters in which the taxpayer was not professionally knowledgeable.

One thing the taxpayer did know about Ernst & Ernst was that they were a highly reputable, competent and respected accounting firm he could rely on.

We asked Ernst & Ernst to prepare a letter for transmittal to the United States Attorney setting forth their knowlegeability with respect to the partnership disputes and accounting problems, and to comment on the instructions they gave in their letters of instructions that accompanied the U.S. Partnership Returns for 1965, 1966, and 1967.

They did so, and we think the letter, which is self-explanatory, will be very helpful to the United States Attorney.[1]

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[1]See Exhibit E-2, Letter From Accounting Firm, Ernst & Ernst, for Submittal to the U.S. Attorney.

Before the taxpayer began consulting with me on this case in November of 1973, he had never heard the expression "guaranteed payments" before. The term came up in a broad-ranging discussion we were having about IRS Regulations. When he asked me if this was pertinent to his case, I advised him point-blank that no matter what considerations had been taken into account by Ernst & Ernst in giving him their instructions in 1966 and 1967, it was their problem and responsibility to propery characterize income and instruct the taxpayer accordingly, and it was his responsibility to follow these instructions, as he did. Otherwise, I explained to him, the client-professional relationship has no standing in the particular field of the professional. I am certain this advice is good law.

I would like to make one final observation about "instructions" and "advice". With respect to the amounts entered on the U.S. Partnership Return, in Schedule K, Column 6, no one, and that includes any individual at Ernst & Ernst or at IRS, ever advised the taxpayer that these amounts were taxable income.

B. The second line of defense is that the act of signing and filing the U.S. Partnership Return with the IRS itself constituted an official "revelation" and non-concealment of the income in question.

This line of defense refutes the intent portion of the charge and is based on two fundamental facts:

1. There is only one Internal Revenue Service.

2. There is only one taxpayer involved.

When one taxpayer communicates all the tax information he has to the IRS in one document (say, on a Form 1040), there is obviously no possible way he can be charged with concealment.

It is when two documents are involved, as in this case, that some people become a little confused about the idea of "concealment".

When two different pieces of information are officially received by the IRS from the same taxpayer, you may have contradiction, but you obviously do not have concealment.

And, more obviously, without concealment, you cannot have intent to evade.

This simple concept -- that when the same sources give two different pieces of information to the same recipient, it is, by definition, impossible to say there has been any concealment -- is difficult to understand for some people.

I think those who have difficulty understanding it have their attention focused exclusively on the source of the information rather than the recipient. What they see is two documents that are different rather than one recipient who has both documents and therefore has been totally informed.

When the IRS receives all the information from the same taxpayer, whether it is in one document or even in six different documents that are all contradictory, it cannot accuse the taxpayer of concealing anything. It can only try to establish which of the documents is correct, and assess a tax accordingly.

In this case, the taxpayer did not conceal the income in question from the IRS. He was the very person who revealed it on the partnership return.

In order to prove concealment, the IRS would have to demonstrate that the taxpayer "existed" as a conveyor of information for the personal return, and somehow did not "exist" as a conveyor of information for the partnership return.

To prove that this taxpayer concealed the amounts in question from the IRS appears to be somewhat impossible.

And without concealment, the charge of intent to evade is refuted.

C. The third line of defense is that the partnership dispute over the computation and division of the net income of the partners makes the alleged income in question only an unresolved element in the dispute.

The dispute over the computation and division of the net income of the partners refutes, by definition, the charge of intent to evade and also questions the certainty of the tax because the certainty of the taxable income is in question.

The only basic way this defense can be challenged is by questioning the existence of the dispute. Strange as it seems, this appears to have been the principal line of investigation of the Special Agent.

This is why, when I saw the copy of the affidavit the Special Agent had obtained from partner Metzger denying the existence of two of the three partnership agreements, I decided to bring to the U.S. Attorney many of the documents which "prove" the existence of a controversy.

The partnership agreement documents (Exhibits A-1 through A-11) show a total of eleven documents that involved one kind of actual or proposed change. These all directly contradict the affidavit obtained by the Special Agent from partner Metzger saying no other agreement ever existed. (Exhibit H-6)

Exhibit H-7 is a chart prepared during the arbitration showing there were the basic operating agreements that succeeded one another, and shows the changes that took place from one agreement to the other.

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Exhibits H-3, H-4, and H-5 show that during the arbitration the accounting firm was unable to prepare U.S. Partnership Returns, and the partnership had to apply for two extensions of time until the arbitration stage was over (September 1970) to file the returns.

Exhibits B-1 through B-16 show the litigation continuing to the point where cross-motions for appeal were filed in March of 1972.

Exhibits E-1 through E-16 show all the documentation to verify that the dispute ended on October 19, 1972, when the taxpayer purchased the entire nursing home business from his former partner.

Exhibits C-1 and C-2 show the absolute multiplicity of issues that existed between the partners.

The trial strategy of the "depreciation" issue is specifically described in Exhibit C-2, pages 32 through 46.

Exhibit G-2 is the authority for the methodology that should be used in applying the allocations of depreciation to "income-before-depreciation" where the percentage allocations of "depreciation" are different from the percentage allocations for "profit".

The "trial strategy" of the litigation required the taxpayer to insist on the literal enforcement of the one-sided depreciation provisions of the partnership agreement in the expectation that if the taxpayer was upheld, it would have produced an economic effect so undesirable for his partner that he would have little choice but to agree to either a "normal" re-alignment of the "depreciation" and "losses" or sell out his interest.

This was the basic message about the relationship of "depreciation" to the ultimate position of the taxpayer that the taxpayer tried to convey, and the Special Agent failed to understand, -- that the trial position of the taxpayer did not have to be consistent with the ultimate re-allocation of "depreciation" and "losses".

The factual basis for this strong "trial strategy", defense counsel points out, is based on an actual specific offer that had already been made by the taxpayer's partner (in January of 1968) to wipe out all the provisions of the agreement covering "depreciation", "losses" and "cumulative profits" and to replace them with a straight 80%-20% split of everything -- which the taxpayer had refused on the basis of unfairness, since he was already claiming a 45% interest in profits under the agreement.

All these documents and the verification of the "trial strategy" show the uninformed interpretations of the Special Agent were all erroneous.

D. The fourth line of defense is that it is not possible, even at this time, to establish the true "taxable income" of the taxpayer without further accounting analysis.

The manner in which the litigation ended - by purchase and sale of the property rather than by court resolution of all the issues affecting the calculation of net income - still preserved

for the taxpayer the right to assert, for income tax purposes, all the arguments against the accounting methods used that were contrary to IRS regulations regarding "depreciation", "losses", "draws", etc.

The right to make these challenges are discussed by the authorities in Exhibits G-1, G-4 and G-5.

What this means is that even at this time the taxpayer must obtain competent professional accounting and/or legal counsel to analyze the effect of the practices that were contrary to the IRS regulations, and then present his analysis to the IRS for discussion and resolution.

On my own part, as counsel to the taxpayer, I have found that the entire one-sided "depreciation" and "losses" allocation that was forced into the partnership by the taxpayer's partner is voidable because of its failure to serve a substantial economic purpose.

What I have <u>not</u> been able to do is to calculate the precise economic effect without benefit of professional accounting counsel.

The fact that both legal and accounting counsel are now indispensable to establish the true "taxable income" of the taxpayer for the entire period from 1965 through 1970, <u>regardless</u> of the outcome of any criminal action, is a direct refutation of any claim of "certainty" of the alleged tax back in 1966 and 1967, that is required to support a charge of tax evasion.

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E. The fifth line of defense is that the application of the IRS Regulation (Section 1.703-1) governing partnership elections makes the alleged income a "non-taxable" draw for all the years the taxpayer received it (1966 through 1970).

This line of defense does not involve one of the "variables" in the computation of partnership income that have previously been discussed.

This is a straightforward, head on, attack on the characterization of the type of income in question.

The amounts received by the taxpayer, in his role of performing services for the partnership, must be treated in exactly the same manner as the amounts received by the other partners in their role of performing services for the partnership -- namely, not as an expense to the partnership, but as a non-taxable draw on taxpayer's capital account.

The requirement that the method of accounting for a particular king of disbursement must apply equally to all partners is very clearly required by the IRS Regulations (Section 1.703-1 Partnership Computations, (b) Elections of the Partnership, (1) General Rule). (See Exhibit G-7 for the excerpt of the general rule).

What this means is that if the partners decide that "services rendered" by any partner shall be charged as an expense to the partnership, this decision must apply to all partners who render services.

They can also decide that money received for services rendered will be a "draw" on their "capital account" or their "drawing account" if they have one.

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In other words, the Regulations say that these types of decisions must be made by "the partnership", and the decisions must "apply equally" to all the partners.

This means that the Regulations do not permit the partners to agree to do things unequally. They cannot agree to have one partner's salary for services rendered to be treated as a "draw", and another partner's salary for services rendered to be treated as an "expense" of the partnership. The salaries for both partners must be either a "draw", or both must be an "expense".

In this case, the whole matter becomes so confusing that I am of the personal opinion that the reason Ernst & Ernst never characterized the amounts shown opposite the taxpayer's name in balance of Schedule K is that they really were not sure at all how to characterize it themselves.

I don't want to get buried in the confusion on this point in this memorandum but I will identify the elements that produced the confusion:

(1) Article 5 of the agreement (Exhibit A-4) set up a "Capital Account".

(2) Article 6 set up a "Drawing (Individual Account". This is the "normal" way to post only "capital" in one account and everything else in the Drawing Account (profits, losses, draws, etc. (See Willis, Exhibit G-3).

(3) The accountants did not set up the Drawing Account, which is one reason for a lot of the trouble.

(4) All "salaries" to partners are normally treated as "draws" from the capital account or the drawing account, if there is one.

(5) There were employment contracts for the other two partners, but everyone agreed their salaries would be "draws" from the "capital account".

(6) The only thing out of step with this "agreement" was the older provision in Article 7 that the taxpayer's draw for services rendered would be charged as an expense to the partnership.

(7) No one ever brought up the "elections" rule of the IRS regulations which would require that all the salaries be "expenses", or all the salaries be"draws." --(Exhibits H-8, H-9).

I think this is enough to show very clearly that the problem for the taxpayer stems partially from the fact that the "elections" Regulation was not applied.

The taxpayer, as I have discussed previously, still has this Regulation available to him. All he needs is the opportunity to assert it.

The consequence to the taxpayer of applying this Regulation alone, without regard to any other considerations, would be that none of the amounts he received as a "draw" would be considered "taxable income" for all the years 1966 through 1970.

This line of defense is a very powerful attack, in its own right, on the certainty of the tax.

III

REFUTATION OF THE UNSUBSTANTIATED INNUENDOS
VOLUNTEERED BY THE SPECIAL AGENT

I have already covered in other sections some of the unsubstantiated conclusions of intent made by the Special Agent that pertained directly to specific items of the controversy such as "depreciation", etc.

Here I want to cover what I consider the difficulty the Special Agent had in understanding why the taxpayer, after not including the items in question on his personal return in the years 1966 and 1967, then did include them in his later returns in the years 1968, 1969 and 1970.

The answer to this question (which the taxpayer did explain) is related to the fact that there were two distinct stages in the controversy.

There was <u>one</u> critical point in time in this entire running dispute when everything changed almost abruptly. This point in time was in January 1969.

Prior to that time, right up through the end of 1968, the partners were "stating" their contrary positions, but they were "talking" to each other in terms of some kind of ultimate resolution of their controversy.

The taxpayer's partners had even made an offer (to which I have already referred) whereby they would <u>eliminate</u> all the sources of controversy, such as the one-sided "depreciation", "losses", "cumulative profit on the capital account", etc., and replace the whole complex method of computation and division of profits

with a straight percentage split of "everything" (which would include "depreciation" and "losses").

This was an attractive expectation for the taxpayer, but the only trouble with the preparation was the "numbers" -- namely, an 80%-20% profit split in favor of the taxpayer's partner.

The taxpayer did not accept the offer on the ground that the ratio was disproportionately unfair because the taxpayer was already claiming 45% of the profits under the existing agreement, even though it may be subject to a "first draw" by his partner for earnings on the "capital account". (See the extract from the arbitration record, Exhibit D-1).

The point of this, of course, is that the taxpayer did have a reasonable expectation at that time, 1967 and 1968, that the status of the "draw" he was receiving would be resolved as a part of the larger solution.

A year later, however, in January 1969, prior to the time the taxpayer filed his 1968 tax return, the entire situation had changed drastically. The atmosphere had reached the "blowup" state, including a direct threat by his partner that it would mean the "end of the partnership" if the taxpayer did not withdraw his objections to making certain disbursements (to his partner's attorney) -- which the taxpayer did withdraw in the interest of trying to preserve harmony. (See excerpt from arbitration record, Exhibit D-2).

Immediately thereafter there was another aborted "incident" involving an unsuccessful attempt by the taxpayer's partner to convince one of the minor partners (Simpson) to go up to Syracuse in January 1969 and physically take over the business by locking the taxpayer out of his office, but the scheme was dropped. (See excerpt from

arbitration record, Exhibit D-3).

Shortly after that, in March of 1969, the two minor partners (Simpson and Metzger) could not stand the heat anymore and sold out their respective interests to the taxpayer and his partner (McKinney)

It was only a month after that, that the taxpayer had to file his personal income tax return in a climate of warfare that made him very concerned about the real possibility of litigation (which actually was started by his partner less than two months later).

Under these circumstances of impending litigation with what was later proven to be an inscrupulous adversary, the taxpayer exercised the most extreme caution possible because he thought it might be made to look "peculiar" if his return showed no income at all. (In 1966 and 1967 the taxpayer had other employment income to enter on his returns).

As it turned out, his suspicions were well-founded because it was his partners who instigated a criminal investigation at a well-timed point in the arbitration.

The Special Agent was not very sympathetic to this explanation because I believe he was no longer, at that point, conducting a fair and impartial investigation.

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IV

THE UNEXPLAINED FACTOR OF THE UNBELIEVABLY LONG AND MISLEADING DELAYS ASSOCIATED WITH THE ENTIRE PROCESSING OF THE INVESTIGATION THAT APPEAR TO VIOLATE THE NORMAL POLICIES OF THE DEPARTMENT OF JUSTICE AND THE IRS

I think it is significant to review the "chronologies" in this case because the case seems to have just "floated around" from place to place for years without anyone doing something about it.

The first time I ever discussed this case with the taxpayer was after he had been informed at his house, by way of an evening television newscast, that he had been indicted in a Federal Court in Utica for criminal tax evasion, and after he had visited the U. S. Attorney to inquire about the indictment.

The taxpayer said he was in a state of bewilderment and surprise because he had heard nothing about his case from anyone in the government since June 1971 - which was 17 months ago, about a year and a half before the indictment.

This surprised me no end. I know from my own experience that the government, as a matter of strict policy, does not leave criminal tax cases languishing in the files.

The taxpayer said that because of the absence of communications from anyone, he thought the matter had been dropped on the strength of his explanations to the representatives of the IRS and I could certainly understand this assumption, even on the basis of my own experience, because the policy in those days was to bring forth an indictment within 90 days of the recommendation made by the IRS.

Memorandum on "The Case for Dismissal"
(Trial brief, 5-30-74 — Exhibit H-1).

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I then obtained from the taxpayer the following chronology of contacts between himself and representatives of the IRS:

Date	Type of Contact	IRS Representatives
7/9/70	Telephone conversation	Michael R. Wilton, Special Agent
7/14/70	Taxpayer interview at IRS, Hunter Plaza	Michael R. Wilton, Special Agent George F. Fitzgerald, Special Agent
7/16/70	Telephone conversation	Michael R. Wilton
7/27/70	Meeting at IRS, Hunter Plaza	Michael R. Wilton
6/1/71	Telephone conversation	Michael R. Wilton
9/1/71	Taxpayer interview at IRS, Hunter Plaza	Michael R. Wilton Leo G. Smith, Group Supervisor
9/2/71	Meeting at IRS, Hunter Plaza	Michael R. Wilton Ian I. Sagar, Special Agent
12/28/71	Meeting at IRS Regional Counsel, NYC	William J. Drew, Attorney John E. Becker Jr., Attorney

There was an obvious point about this chronology that appeared out of the ordinary.

This was the extraordinary length of time between the first series of contacts and meetings with the taxpayer in July of 1970, and the issuance of the indictment in November of 1973. There was a span here of over three and one-half years.

Even after the last conference between the taxpayer and the IRS Regional Office in New York City there is a span of two years.

The taxpayer also had a letter from the IRS Regional Office saying the matter was being forwarded to the Department of Justice

in Washington in June of 1971, 6 months after the taxpayer's visit to New York. Even from this point in time, it was over a year and five months before the indictment was handed down.

All these long time-frames made me wonder what could possibly have caused these delays -- especially since the nature of the case was a simple "specific items" case.

I expected that during my own investigation of the case, I would run across the answer to the question. But I did not. I am still unaware of why this case took so incredibly long to come to a point of disposition.

What makes the whole thing a little more mysterious is that the taxpayer had already been through a civil audit for the calendar year 1968 (completed in July 1969). This audit had taken place one year prior to, and had no connection with, the subsequent triggering of the investigation by his partner.

During this civil audit, the government auditor raised no question about any inconsistency between the taxpayer's personal return and the partnership returns he had signed.

Whatever the reason for these delays, it hardly seems fair to put a taxpayer through these lingering interludes that could impart to the taxpayer the idea that the investigation was dropped.

In any event, I think this is a clear violation of the basic policies of both the Department of Justice and the IRS.

(Partnership Agreements — Group A) *

Index to Group A.

Re U.S. v. Thomas Fahey

A

GROUP A

Exhibit #	Partnership Agreement Documents		Arbitration Exhibits
A-1 11/23/64	First Partnership Agreement	- General Partnership	Ex. A; T109
A-2 1/4/65	Second Partnership Agreement	- Limited Partnership	Ex. E; T129
A-3 2/9/65	Amend to Second Agreement	- Capital Contribution	Ex. F; T145
A-4 11/16/65	Third Partnership Agreement	- General Partnership	Ex. G; T168
A-5 8/1/66	First Amend to Third Agreement	- Name Change	Ex. G; T168
A-6 9/1/67	Auxiliary Partnership Agreement for Home for Adults	- General Partnership	Ex. 2; T38
A-7 9/--/67	Letter Agreement to Amend Auxiliary Partnership Agreement dated 9/1/67	- General Partnership	Ex. 2; T32
A-8 11/5/68	Proposed Second Amend to third Agreement (1st draft) (partially signed)	- Proposed new partner Proposed new purchase option	Ex. SS; T35
A-9 1/5/69	Proposed Second Amend to third Agreement (2d draft) (Partially signed)	- Proposed new partner	Ex. 5; T32
A-10 3/12/69	Purchase Agreement Between Partners	- Fahey Purchase of Simpson Interest	Ex. WW; T5
A-11 3/25/69	Proposed Second Amend to Third Agreement (3rd draft) (signed without provision for Fahey's signature)	- New Partner (Jane McKinney)	Ex. 1; T385

(Partnership Agreements — Group A) *

Exhibit A-1 — First Partnership Agreement, General Partnership (11/26/64).

NOVEMBER 23, 1964

MEMO OF UNDERSTANDING BETWEEN
THOMAS FAHEY
WALKER MCKINNEY
GEORGE SIMPSON
THEODORE METZGER

EXH A-1

MORE COMPLETE FORMAL AGREEMENT TO BE PREPARED AND ON FILE

AN AGREEMENT IS MADE THIS DATE BASED ON FINAL LEGAL APPROVAL BY COUNSEL FOR THE PARTIES CONCERNED TO:

1. Make a purchase offer of $350,000 for the purchase of Syracuse General Hospital. This amount shall be a gross purchase offer to include a negotiated brokerage commission. The brokerage commission shall be payable 75% to this partnership and 25% to Gallagher and Kiernan, attorneys, if they shall agree to do all necessary legal work up to and including closing, agree to hold the partnership harmless against any and all claims for payment of brokerage commissions on the sale of the Syracuse General Hospital and release the partnership from claims for services, legal and otherwise, for services performed in connection with this matter.

2. It is our intention at this point to enter into a construction contract on a cost plus $30,000 fixed fee basis. We are fully aware that we will issue for mortgage purposes a construction contract somewhat in the neighborhood of $200,000 above the actual cost estimate. This spread between actual cost estimate and building contract amount shall be divided in such a way that savings realized shall be shared between this partnership and the builders at approximately a 75% - 25% split.

3. The partnership shall be set up on the following basis: Walker McKinney, for 85% of cash investment in the project, will have a 42.5% share of all profits from same as hereinafter clarified. George Simpson, for 15% of cash investment in the project, shall have a 7.5% share of all profits in same as hereinafter clarified. For services contributed, Thomas Fahey shall have a 45% share of all profits from the project and Theodore Metzger a 5% share again as hereinafter clarifiedl

Payouts on the above profit percentages shall be distributed as follows. McKinney and Simpson shall receive first a 20% return on any cash investment, cumulative from time cash enters the partnership. At such time as said 20% has been cumulatively paid to date, the aforesaid will continue to receive the first 20% of return on their cash investment, additional return thereafter going the first 20% to Fahey and Metzger, and thereafter to be divided 50-50.

(Partnership Agreements — Group A) *
Exhibit A-1 — First Partnership Agreement, General Partnership (11/26/64).

4. It is assumed that the cash investment involved in this project by the above mentioned cash investors is to be up to an amount of $100,000.

5. In the event that additional funds over and above the $100,000 figure mentioned above are required from the cash investors, these cash investors shall gain an additional 5% equity position for each $25,000 of additional investment involved, these additional percentages to be allocated to the cash investors in proportion to their additional individual investments.

6. The cash investors, irregardless of the above profit sharing arrangement, shall have a 60% voting control of the project, proportionate to their individual cash investments division-wise, from the inception of the project until a date one year after closing of the purchase of the property. If at any time within this period the cash investors shall have returned to them an amount equal to their actual cash investment, then control of the project shall be based soley on the profit sharing percentages mentioned above... namely, McKinney 42.5%, Simpson 7.5%, Metzger 5%, and Fahey 45%.

Repayment of cash investor money shall not be limited soley to profits from operations, but may accrue from proceeds of mortgages, chattel mortgaging of equipment or furnishings, or resale of incidental real properties involved, or such other mechanisisms as shall be mutually acceptable to all parties.

Agreed this date:

Walter McKinney

T. Travis McFahey

George Simpson

Theodore Metzger

Exh A-2

ARTICLES OF PARTNERSHIP

of

WALKER McKINNEY ASSOCIATES

It is agreed among the undersigned that from the 4th day of January, 1965, and thenceforth these presents shall constitute the Articles of Partnership of WALKER McKINNEY ASSOCIATES.

ARTICLE 1

PURPOSES

1. The Purposes of the partnership shall be to own and operate a Nursing Home in Syracuse, New York and such additional sites as shall be determined from time to time and to do all things incidental thereto, including the purchase of necessary real estate and equipment thereof for such Nursing Home purposes. The title to all assets of the partnership, real or personal, shall be held in the name of the partnership.

ARTICLE 2

NAME AND LOCATION

2. The name of the partnership is WALKER McKINNEY ASSOCIATES and its principal place of business is in the City of Syracuse, State of New York. The partnership may transact business at such other or additional places within or without the State of New York as it may from time to time determine.

ARTICLE 3

PARTNERS

3.1 The partnership consists of one (1) general partner, and three (3) limited partners whose names and addresses are as follows:

GENERAL PARTNER

WALKER McKinney	47 East 87th Street New York, New York 10028

LIMITED PARTNERS

THEODORE METZGER	206 Fellows Avenue Syracuse, New York
THOMAS FAHEY	415 Stratford Street Syracuse, New York
GEORGE SIMPSON, M. D.	592 Park Avenue East Orange, New Jersey 07109

3.2 Additional partners may be admitted upon such terms and conditions as shall be agreed upon by a majority in interest of the general partners.

ARTICLE 4

DURATION

4. The partnership shall continue until terminated as provided herein.

ARTICLE 5

CAPITAL

5.1 The partners will contribute to the capital account of the partnership as set forth on Schedule A attached hereto.

5.2 Without the prior written consent of a majority interest of the general partners, no partner may increase or withdraw all or any part of his capital contribution.

5.3 Upon the death of any partner his capital account shall be retained by the partnership as a capital account in the name of such former partner, subject to the risks of the business.

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ARTICLE 6

PARTNERS' INDIVIDUAL ACCOUNTS

6.1 All cash, securities and other property of any kind or nature and all interests therein which may from time to time be held by the partnership for the individual account of any partner (excluding all cash, securities or other property segregated or in a safekeeping account) shall forthwith upon the receipt thereof by the partnership, become and be partnership property and be treated for all purposes as capital contributed by such partner; provided, however, that solely for the purpose of determining the rights of the partners among themselves (a) all profits and income earned and losses and charges incurred in connection with such cash, securities and other property so held shall be credited or charged to such partner's individual account and shall not constitute partnership income or expense, and (b) except as otherwise herein provided none of such cash, securities or other property so held shall be deemed capital or funds of the partnership with respect to any of the rights or obligations of the partners as among themselves granted or imposed by law or by these Articles.

6.2 Nothing contained in Section 6.1 hereof shall be construed to prevent any partner from investing or re-investing any such cash, securities or other property so held for his individual account, or from pledging or hypothecating any such securities or other property or from withdrawing any of the same from such account at any time.

6.3 Upon the termination or dissolution of the partnership, or upon any partner's ceasing to be a partner for any reason, he or his legal representative shall have a claim against the partnership with respect to such cash, securities and other property held in such partner's individual

account, which claim shall be subordinate in right of payment and subject to the prior payment or provision for payment in full of all claims of present and future creditors of the partnership (and any successor partnership in which he shall have been a partner) arising out of any matter occurring before the termination of such partnership (or successor partnership) or before his ceasing to be a partner therein.

ARTICLE 7

PROFITS AND LOSSES

7.1 THOMAS FAHEY or his successor as administrator shall be paid a salary of Twenty Thousand Dollars ($20,000) per year, which salary may be drawn by him in monthly installments. Such salary, for purposes of division of partnership's net profits and losses, shall be treated as an expense of the partnership.

7.2 WALKER McKINNEY and GEORGE SIMPSON shall be entitled to receive from the first profits of the partnership a 20% return on their capital account, as it may exist from time to time, which return shall be a first charge on all profits as they occur from year to year and shall be cumulative in nature from the inception of the partnership.

7.3 After the payment of salary as provided in 7.1 above and the distribution of profits with respect to capital accounts as provided in 7.2 above, an amount of yearly net profits equal to the distributions of profits under 7.2 above shall be distributed as follows:

THOMAS FAHEY	90%
THEODORE METZGER	10%

This distribution shall be on an annual basis and shall not be cumulative.

7.4 The additional net profits and all of the losses of the partnership shall be allocated as follows:

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	Net Profits	Net Losses
WALKER McKINNEY	42.5%	85%
GEORGE SIMPSON	7.5%	15%
THOMAS FAHEY	45.0%	--
THEODORE METZGER	5.0%	--

7.5 The distributions provided in 7.3 above and 7.4 above to THOMAS FAHEY are dependent upon his employment as administrator of the Nursing Home except that for each full calendar year of satisfactory service commencing January 1, 1965, and terminating December 31, 1974, he shall be entitled to a 9.0% distribution under 7.3 above up to a maximum of 90% and a 4.5% distribution under 7.4 above up to a maximum of 45% regardless of employment.

7.6 In the event that the partnership shall be liquidated, after December 31, 1974, each partner shall be entitled to his capital account and the excess assets over liabilities shall be distributed among the partners in accordance with the distribution of additional net profits under 7.4 above. In the event that the liquidation shall occur prior to December 31, 1974, then the distribution to THOMAS FAHEY shall be limited to his percentage which has been vested regardless of employment and the excess shall be distributed among WALKER McKINNEY and GEORGE SIMPSON in accordance with their then capital account.

7.7 In the event that all capital contributions made by WALKER McKINNEY and GEORGE SIMPSON are repaid to them by the partnership within one year from the date of the acquisition of the General Hospital of Syracuse, then THOMAS FAHEY shall be immediately vested with his maximum distributions under 7.5 above, regardless of employment or years of service.

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ARTICLE 9

WITHDRAWAL

9.1 Any partner may voluntarily withdraw from the partnership at any time by written notice of his intention to withdraw, served either personally upon any other partner or by registered mail addressed to the partnership at its principal office. Any partner so giving notice shall cease to be a partner as of the close of business on the day such notice is received.

ARTICLE 10

EXPULSION WITHOUT NOTICE

10.1 Any partner who shall be declared an incompetent in any judicial proceeding, or who shall make an assignment for the benefit of creditors, or shall file or consent to the filing against him of a petition in bankruptcy against him or shall fail to have dismissed within thirty days any petition in bankruptcy filed against him, or shall take advantage of any laws for the benefit of insolvent or indigent debtors, or shall institute any proceedings for the dissolution or winding up of the partnership, shall thereupon cease to be a partner.

ARTICLE 11

EXPULSION WITH NOTICE

11.1 Any partner who shall violate any of the provisions of these Articles in any respect, or who shall become insolvent or do or suffer anything indicative thereof, or become of unsound mind, or become in any way incapable of performing his functions as a partner, or shall be guilty of such conduct as tends to affect adversely the carrying on of the business of the partnership, or shall otherwise so conduct himself in matters relating to the partnership business that it is not reasonably practicable to carry on the business of the partnership with him, shall cease to be a partner upon receipt of written notice of the termination of his partnership

signed by a majority in interest of the partners, which notice shall state the cause of such termination and shall be served upon each partner either personally or by registered mail at his home address as it appears on the records of the pertnership.

ARTICLE 12

PURCHASE OF INTEREST OF LIMITED PARTNERS

In the event that (1) a limited partner wishes to terminate his interest in the partnership or in the event that (2) a majority in interest of the general partners decide that it is in the best interest of the partnership for a limited partner to withdraw, then the following procedure shall occur.

(A) A limited partner or partners may withdraw upon ninety (90) days notice in writing and the partnership shall be required to purchase his or their interests for the amount determined in (C) below.

(B) Upon determination in writing by a majority in interest of the general partners which notice shall be served upon each partner either personally or by registered mail at his home address as it appears on the records of the partnership and upon ninety (90) days notice, a limited partner or partners may be required to withdraw and sell his or their interests to the partnership for the amount determined in (C) below.

(C) Such partner's interest according to the last certified statement and verification of his account or the last signed quarterly statement (whichever shall be later), prepared as of a date previous to the date he ceased to be a partner, shall be the basic figure.

(D) To such figure shall be added all increases in such partner's interest during the period from the date of such statement and verification to and including the date he ceased to be a partner including such partner's share, if any, of undistributed profit computed as provided in Paragraph (E) hereof and all other credits properly to be made to his account with respect to such period. From the sum so determined there shall be deducted all decreases in such partner's interest during the period from such statement and verification to and

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including the date he ceased to be a partner, including such partner's share (if any) of losses computed as provided in Paragraph (D) hereof and all other debits properly to be made to his account with respect to such period.

(E) Such former partner's share of the profits or losses for the fiscal quarter in which he ceases to be a partner shall be computed by applying his appropriate percentage participation in profits or losses to a fraction of such quarter's profits or losses, the denominator of which shall be the total number of days in such quarter and the numerator of which shall be the number of days in such quarter during which he continued to be a partner.

(F) Within ninety (90) days from the date a partner ceased to be such there shall be paid over and delivered to him or his legal representative, his entire interest in the partnership as above computed.

(F.1) To such figure, with respect to Theodore Metzger, shall be added the sum of $10,000. and

(F.2) To such figure, with respect to Thomas Fahey, shall be added the sum of $90,000.

(F.3) To such figure, with respect to George Simpson, shall be added the sum of $15,000.

Before paying out the interest of any former partner, the partnership may require that any indebtedness of said partner to the partnership shall first be satisfied.

In computing a former partner's interest no value shall be attributed to good will, to the partnership name, or to office furniture, fixtures, or equipment. The former partner or his legal representative shall, however, be given a statement of all such accounts.

And in the event that Walker McKinney and George Simpson are required to furnish capital contributions in

excess of the amount set forth in Schedule A attached hereto, then and in that event for each $25,000 additional capital contribution required, Walker McKinney and George Simpson shall receive jointly an additional 5% of the net profits allocated under Article 7.4, and Thomas Fahey shall have a reduction in net profits of an equivalent amount of the contributions of additional capital, and the division of net profits required thereby shall be determined by a majority of interest of the general partners.

ARTICLE 13

MANAGEMENT OF PARTNERSHIP

Except as otherwise provided by law and except as otherwise specifically provided in these Articles, all actions required or permitted herein to be taken by the partnership, and all questions of policy, judgment, management, discretion, or otherwise relating to the business of the partnership shall, after consultation among all the partners be determined by the general partner or if there be more than one by a majority in interest of the general partners. For the purposes of these Articles a majority in interest shall mean a majority of the income distributions to the general partners.

ARTICLE 14

BOOKS OF ACCOUNT AND STATEMENTS

16.1 The partnership shall at all times keep complete and accurate books of account concerning all transactions and all other matters and things pertaining to the partnership and its business, based upon a calendar year commencing January 1, 1965.

16.2 The accounts of the partnership shall be audited and a statement thereof shall be prepared and certifie

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by certified public accountants at least once each year and in connection with such audit there shall be a verification of each partner's interest in the partnership. As of the close of each fiscal quarter, income and expense statements shall be prepared by certified public accountants or by employees of the partnership and signed by each of the partners.

16.3 The signed statements prepared as of the close of each fiscal quarter, and the annual certified statement and verification of each partner's interest in the partnership as provided in Section above, shall be binding and conclusive on each partner.

ARTICLE 15

ARBITRATION

17.1 Any claim or controversy arising out of or in any way relating to these Articles or the breach or application thereof shall be settled by arbitration in accordance with the rules then obtaining of the American Arbitration Association. Any arbitration award or determination made pursuant to this Section shall be final and binding upon all parties hereto and their legal representatives, and judgment thereon may be entered in any court having jurisdiction thereof

ARTICLE 16

EFFECT AND CONSTRUCTION

18.1 These Articles and the performance hereof at all times shall be subject to, shall be construed in light of and, to the extent inconsistent therewith, shall be deemed modified pro tanto by (a) the rules and regulations of the State of New York, Department of Welfare, in connection with the operation of nursing homes.

(Partnership Agreements — Group A) *
Exhibit A-2 — Second Partnership Agreement, Limited Partnership (1/4/65).

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These presents shall be binding upon the parties hereto, their heirs and legal representatives.

ARTICLE 17

CONTINUATION OF PARTNERSHIP

17.1 The death, withdrawal purchase of interest of a limited partner, or expulsion of a partner shall not terminate the partnership and the remaining partners shall continue the partnership's business with the exclusive right to enjoy the good will and use the name of the partnership.

IN WITNESS WHEREOF, the undersigned have hereunto set their hands and seals on the 4th day of January, 1965.

GENERAL PARTNER

Walker McKinney (L.S.)
Walker McKinney

_____

_____
Witnesses

LIMITED PARTNERS

Theodore Metzger (L.S.)
Theodore Metzger

_____

_____
Witnesses

Thomas Fahey (L.S.)
Thomas Fahey

_____

_____
Witnesses

George Simpson (L.S.)
George Simpson

_____

_____
Witnesses

(Partnership Agreements — Group A)*

Exhibit A-2 Second Partnership Agreement, Limited Partnership (1/4/65).

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TATE OF NEW YORK
OUNTY OF ONONDAGA SS:
ITY OF SYRACUSE

On this 4th day of January, Nineteen Hundred and ixty Five, before me, the subscriber, personally appeared ALKER MC KINNEY, THEODORE METZGER, THOMAS FAREY, and ORGE SIMPSON, to me personally known and known to me to e the same persons described in and who executed the within nstrument, and they acknowledged to me that they executed ie same.

Daniel J. Kornan

DANIEL J. KORNAN, ESQ.
[illegible]

(Partnership Agreements — Group A)*
Exhibit A-2 — Second Partnership Agreement, Limited Partnership (1/4/65).

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SCHEDULE A

CAPITAL CONTRIBUTIONS

Partner	Capital
Walker McKinney	$ 85,000
George Simpson	15,000
Theodore Metzger	None
Thomas Fahey	None
	$100,000

(Partnership Agreements — Group A) *
Exhibit A-3 — Amend to Second Agreement, Capital Contribution (2/9/65).

Exh A-3

AMENDMENT

TO

ARTICLES OF PARTNERSHIP

OF

WALKER McKINNEY ASSOCIATES

It is agreed among the undersigned that from the 9 day of February, 1965, and thenceforth the Articles of Partnership of WALKER McKINNEY ASSOCIATES executed by the undersigned on the 4th day of January, 1965, shall be amended as follows:

Schedule "A" concerning the capital contributions to the partnership shall henceforth read:

SCHEDULE A

CAPITAL CONTRIBUTIONS

Partner	Capital
Walker McKinney	$ 85,000
George Simpson	15,000
Theodore Metzger	2,000
Thomas Fahey	None
	$102,000

IN WITNESS WHEREOF, the undersigned have hereunto set their hands and seals on the 9 day of February, 1965.

Walker McKinney

State of Texas

9 day of February, 1965, before me, the
, known to me to be the person whose name is
subscribed to the foregoing instrument, and acknowledged to me that they

(Partnership Agreements — Group A) *

Exhibit A-4 — Third Partnership Agreement, General Partnership (11/16/65).

ARTICLES OF PARTNERSHIP

of

WALKER McKINNEY ASSOCIATES

It is agreed among the undersigned that from the 16th day of November, 1965, and thenceforth these presents shall constitute the Articles of Partnership of WALKER McKINNEY ASSOCIATES, a general partnership, and that these articles shall replace the articles of the partnership of Walker McKinney Associates, a limited partnership, heretofore entered into by the parties hereto on the 4th day of January, 1965; the said limited partnership being dissolved on the date of the signing of these presents.

ARTICLE 1

PURPOSES

1. The Purposes of the partnership shall be to own and operate a Nursing Home in Syracuse, New York and such additional sites as shall be determined from time to time and to do all things incidental thereto, including the purchase of necessary real estate and equipment thereof for such Nursing Home purposes. The title to all assets of the partnership, real or personal, shall be held in the name of the partnership.

ARTICLE 2.

NAME AND LOCATION

2. The name of the partnership is WALKER McKINNEY ASSOCIATES and its principal place of business is in the City of Syracuse, State of New York. The partnership may transact business at such other or additional places within or without the State of New York as it may from time to time determine.

ARTICLE 3

PARTNERS

3.1 The partnership consists of four (4) general partners; one (1) senior partner and three (3) junior partners, whose names and addresses are as follows:

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SENIOR PARTNER

WALKER McKINNEY	47 East 87th Street New York, New York 10028

JUNIOR PARTNERS

THEODORE METZGER	206 Follows Avenue Syracuse, New York
THOMAS FAHEY	415 Stratford Street Syracuse, New York
GEORGE SIMPSON, M. D.	592 Park Avenue East Orange, New Jersey 07109

3.2 Additional partners may be admitted upon such terms and conditions as shall be agreed upon by the Senior Partner.

ARTICLE 4

DURATION

4. The partnership shall continue until terminated as provided herein.

ARTICLE 5

CAPITAL

5.1 The partners will contribute to the capital account of the partnership as set forth on Schedule "A" attached hereto; and contributions heretofore made to the limited partnership of Walker McKinney Associates shall constitute payments to the capital account of this general partnership.

5.2 Without the prior written consent of the senior partner, no partner may increase or withdraw all or any part of his capital contribution.

5.3 Upon the death of any partner his capital account shall be retained by the partnership as a capital account in the name of such former partner, subject to the risks of the business.

ARTICLE 6

PARTNERS' INDIVIDUAL ACCOUNTS

6.1 All cash, securities and other property of any kind or nature and all interests therein which may from time to time

be held by the partnership for the individual account of any partner (excluding all cash, securities or other property segregated or in a safekeeping account) shall forthwith upon the receipt thereof by the partnership, become and be partnership property and be treated for all purposes as capital contributed by such partner; provided, however, that solely for the purpose of determining the rights of the partners among themselves (a) all profits and income earned and losses and charges incurred in connection with such cash, securities and other property so held shall be credited or charged to such partner's individual account and shall not constitute partnership income or expense, and (b) except as otherwise herein provided none of such cash, securities or other property so held shall be deemed capital or funds of the partnership with respect to any of the rights or obligations of the partners as among themselves granted or imposed by law or by these Articles.

6.2 Nothing contained in Section 6.1 hereof shall be construed to prevent any partner from investing or re-investing any such cash, securities or other property so held for his individual account, or from pledging or hypothecating any such securities or other property or from withdrawing any of the same from such account at any time.

6.3 Upon the termination or dissolution of the partnership, or upon any partner's ceasing to be a partner for any reason, he or his legal representative shall have a claim against the partnership with respect to such cash, securities and other property held in such partner's individual account, which claim shall be subordinate in right of payment and subject to the prior payment or provision for payment in full of all claims of present and future creditors of the partnership (and any successor partnership in which he shall have been a partner) arising out of any matter occurring before the termination of such partnership (or successor partnership) or before his ceasing to be a partner

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therein.

ARTICLE 7

PROFITS AND LOSSES

7.1 THOMAS FAHEY, or his successor, as administrator shall be paid a salary of Twenty Thousand Dollars ($20,000.00) per year, which salary may be drawn by him in monthly installments. Such salary, for purposes of division of partnership's net profits and losses, shall be treated as an expense of the partnership.

7.2 WALKER McKINNEY and GEORGE SIMPSON shall be entitled to receive from the first profits of the partnership a 20% return on their capital account, as it may exist from time to time, which return shall be a first charge on all profits as they occur from year to year and shall be cumulative in nature from the inception of the partnership.

7.3 After the payment of salary as provided in 7.1 above and the distribution of profits with respect to capital accounts as provided in 7.2 above, an amount of yearly net profits equal to the distribution of profits under 7.2 above shall be distributed as follows:

THOMAS FAHEY	90%
THEODORE METZGER	10%

This distribution shall be on an annual basis and shall not be cumulative.

7.4 The additional net profits and all of the losses of the partnership shall be allocated as follows:

	Net Profits	Net Losses
WALKER McKINNEY	42.5%	85%
GEORGE SIMPSON	7.5%	15%
THOMAS FAHEY	45.0%	--
THEODORE METZGER	5.0%	--

7.5 The distributions provided in 7.3 above and 7.4 above to THOMAS FAHEY are dependent upon his employment as administrator of the Nursing Home except that for each full calendar year

of satisfactory service commencing January 1, 1965, and terminating December 31, 1974, he shall be entitled to a 9.0% distribution under 7.3 above up to a maximum of 90% and a 4.5% distribution under 7.4 above up to a maximum of 45% regardless of employment.

7.6 In the event that the partnership shall be liquidated, after December 31, 1974, each partner shall be entitled to his capital account and the excess assets over liabilities shall be distributed among the partners in accordance with the distribution of additional net profits under 7.4 above. In the event that the liquidation shall occur prior to December 31, 1974, then the distribution to THOMAS FAHEY shall be limited to his percentage which has been vested regardless of employment and the excess shall be distributed among WALKER McKINNEY and GEORGE SIMPSON in accordance with their then capital account.

7.7 In the event that all capital contributions made by WALKER McKINNEY and GEORGE SIMPSON are repaid to them by the partnership within one year from the date of the acquisition of the General Hospital of Syracuse, then THOMAS FAHEY shall be immediately vested with his maximum distributions under 7.5 above, regardless of employmsnt or years of service.

ARTICLE 8

OWNERSHIP OF PARTNERSHIP PROPERTY

8.1 The partners intend and agree that the general rule set forth in Section 704 (c) (1) of the Internal Revenue Code shall not apply and that the depreciation with respect to property owned by the partnership shall be allocated 85% to WALKER McKINNEY and 15% to GEORGE SIMPSON in accordance with the allocation of the net losses under Article 7.4 of this Agreement.

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ARTICLE 9

WITHDRAWAL

9.1 Any partner may voluntarily withdraw from the partnership at any time by written notice of his intention to withdraw, served either personally upon any other partner or by registered mail addressed to the partnership at its principal office. Any partner so giving notice shall cease to be a partner as of the close of business on the day such notice is received.

ARTICLE 10

EXPULSION WITHOUT NOTICE

10.1 Any partner who shall be declared an incompetent in any judicial proceeding, or who shall make an assignment for the benefit of creditors, or shall file or consent to the filing against him of a petition in bankruptcy against him or shall fail to have dismissed within thirty days any petition in bankruptcy filed against him, or shall take advantage of any laws for the benefit of insolvent or indigent debtors, or shall institute any proceedings for the dissolution or winding up of the partnership, shall thereupon cease to be a partner.

ARTICLE 11

EXPULSION WITH NOTICE

11.1 Any partner who shall violate any of the provisions of these Articles in any respect, or who shall become insolvent or do or suffer anything indicative thereof, or become of unsound mind, or become in any way incapable of performing his functions as a partner, or shall be guilty of such conduct as tends to affect adversely the carrying on of the business of the partnership, or

shall otherwise so conduct himself in matters relating to the partnership business that it is not reasonably practicable to carry on the business of the partnership with him, shall cease to be a partner upon receipt of written notice of the termination of his partnership signed by the senior partner, which notice shall state the cause of such termination and shall be served upon each partner either personally or by registered mail at his home address as it appears on the records of the partnership.

ARTICLE 12

PURCHASE OF INTEREST OF JUNIOR PARTNERS

In the event that (1) a junior partner wishes to terminate his interest in the partnership or in the event that (2) the senior partner decides that it is in the best interest of the partnership for a junior partner to withdraw, then the following procedure shall occur:

(A) A junior partner or partners may withdraw upon ninety (90) days notice in writing and the partnership shall be required to purchase his or their interests for the amount determined in (C) below.

(B) Upon determination in writing by the senior partner, which notice shall be served upon each partner either personally or by registered mail at his home address as it appears on the records of the partnership and upon ninety (90) days notice, a junior partner or partners may be required to withdraw and sell his or their interests to the partnership for the amount determined in (C) below.

(C) Such partner's interest according to the last certified statement and verification of his account or the last signed quarterly statement (whichever shall be later), prepared as of a date previous to the date he ceased to be a partner, shall be the basic figure.

(D) To such figure shall be added all increases in such

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partner's interest during the period from the date of such statement and verification to and including the date he ceased to be a partner including such partner's share, if any, of undistributed profit computed as provided in Paragraph (E) hereof and all other credits properly to be made to his account with respect to such period. From the sum so determined there shall be deducted all decreases in such partner's interest during the period from such statement and verification to and including the date he ceased to be a partner, including such partner's share (if any) of losses computed as provided in Paragraph (E) hereof and all other debits properly to be made to his account with respect to such period.

(E) Such former partner's share of the profits or losses for the fiscal quarter in which he ceases to be a partner shall be computed by applying his appropriate percentage participation in profits or losses to a fraction of such quarter's profits or losses, the denominator of which shall be the total number of days in such quarter and the numerator of which shall be the number of days in such quarter during which he continued to be a partner.

(F) Within ninety (90) days from the date a partner ceased to be such there shall be paid over and delivered to him or his legal representative, his entire interest in the partnership as above computed.

(F.1) To such figure, with respect to Theodore Metzger, shall be added the sum of $10,000.00; and

(F.2) To such figure, with respect to Thomas Fahey, shall be added the sum of $90,000.00; and

(F.3) To such figure, with respect to George Simpson, shall be added the sum of $10,000.00.

(G) Before paying out the interest of any former partner, the partnership may require that any indebtedness of said partner to the partnership shall first be satisfied.

(G.1) In computing the [illegible] partner's interest, no

value shall be attributed to good will, to the partnership name, or to office furniture, fixtures, or equipment. The former partner or his legal representative shall, however, be given a statement of all such accounts.

(H) In the event that Walker McKinney and George Simpson are required to furnish capital contributions in excess of the amount set forth in Schedule A attached hereto, then and in that event for each $25,000 additional capital contribution required, Walker McKinney and George Simpson shall receive jointly an additional 5% of the net profits allocated under Article 7.4, and Thomas Fahey shall have a reduction in net profits of an equivalent amount of the contributions of additional capital, and the division of net profits required thereby shall be determined by the Senior Partner.

ARTICLE 13

MANAGEMENT OF PARTNERSHIP

Except as otherwise provided by law and except as otherwise specifically provided in these Articles, all actions required or permitted herein to be taken by the partnership, and all questions of policy, judgment, management, discretion, or otherwise relating to the business of the partnership shall, after consultation among all the partners, be determined by the Senior Partner.

ARTICLE 14

BOOKS OF ACCOUNT AND STATEMENTS

14.1 The partnership shall at all times keep complete and accurate books of account concerning all transactions and all other matters and things pertaining to the partnership and its

business, based upon a calendar year commencing January 1, 1965.

14.2 The accounts of the partnership shall be audited and a statement thereof shall be prepared and certified by certified public accountants at least once each year and in connection with such audit there shall be a verification of each partner's interest in the partnership. As of the close of each fiscal quarter, income and expense statements shall be prepared by certified public accountants or by employees of the partnership and signed by each of the partners.

14.3 The signed statements prepared as of the close of each fiscal quarter, and the annual certified statement and verification of each partner's interest in the partnership as provided in Section 14.2 above, shall be binding and conclusive on each partner.

ARTICLE 15

ARBITRATION

15.1 Any claim or controversy arising out of or in any way relating to these Articles or the breach or application thereof shall be settled by arbitration in accordance with the rules of the American Arbitration Association then in effect. Any arbitration award or determination made pursuant to this Section shall be final and binding upon all parties hereto and their legal representatives, and judgment thereon may be entered in any court having jurisdiction thereof.

ARTICLE 16

EFFECT AND CONSTRUCTION

16.1 These Articles and the performance hereof at all times shall be subject to, shall be construed in light of and, to the

extent inconsistent therewith, shall be deemed modified pro tanto by (a) the rules and regulations of the State of New York, Department of Welfare, in connection with the operation of nursing homes.

These presents shall be binding upon the parties hereto, their heirs and legal representatives.

ARTICLE 17

CONTINUATION OF PARTNERSHIP

17.1 The death, withdrawal purchase of interest of a junior partner, or expulsion of a partner shall not terminate the partnership and the remaining partners shall continue the partnership's business with the exclusive right to enjoy the good will and use the name of the partnership.

IN WITNESS WHEREOF, the undersigned have hereunto set their hands and seals on the 15th day of November, 1965.

SENIOR PARTNER

Walker McKinney (L.S.)

Witnesses

JUNIOR PARTNERS

George Simpson (L.S.)

Witnesses

Theodore Metz (L.S.)

Witnesses

Thomas Fahey (L.S.)

Witnesses

(Partnership Agreements — Group A) *
Exhibit A-4 — Third Partnership Agreement, General Partnership (11/16/65).

-12-

STATE OF NEW YORK
COUNTY OF ONONDAGA ss:
CITY OF SYRACUSE

On this 16th day of November, Nineteen Hundred and Sixty Five, before me, the subscriber, personally appeared WALKER McKINNEY, GEORGE SIMPSON, THEODORE METZGER and THOMAS FAHEY, to me personally known and known to me to be the same persons described in and who executed the within Instrument, and they acknowledged to me that they executed the same.

Notary Public
3/31/66

(Partnership Agreements — Group A)*
Exhibit A-4 — Third Partnership Agreement, General Partnership (11/16/65).

A-4

SCHEDULE A

CAPITAL CONTRIBUTIONS

Partner	Capital
Walker McKinney	$ 88,000
George Simpson	10,000
Theodore Metzger	2,000
Thomas Fahey	None
	$102,000

(Partnership Agreements — Group A)*
Exhibit A-4 — Third Partnership Agreement, General Partnership (11/16/65).

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14

415 Stratford Street
Syracuse, New York
September 21, 1965

Mr. Walker McKinney
47 East 87th Street
New York, New York 10028

COPY

Dear Walker:

This is to confirm the fact that I agree to obtain your specific approval before disposing of any interest in the Castle Rest Nursing Home that shall be vested in me.

Very truly yours,

Thomas M. Fahey

TMF:ifw

AMENDMENT TO PARTNERSHIP

THIS AMENDING AGREEMENT, made this 1st day of August, 1966, by and between the undersigned.

WHEREAS, the parties hereto entered into written Articles of partnership dated the 16th day of November, 1965 and;

WHEREAS, the parties hereto desire to amend "ARTICLE II" nd the preamble of said agreement;

NOW, THEREFORE, it is mutually agreed among the parties hereto as follows:

First: All reference to "WALKER MC KINNEY ASSOCIATES" as contained in the preamble and "ARTICLE II" of said Articles of Partnership, shall be deleted and the following new name "CASTLE REST NURSING HOME" shall be inserted in place of the former name.

SECOND: That the general partnership formerly known as "WALKER MC KINNEY ASSOCIATES" shall continue uninterrupted under the new name of the partnership, "CASTLE REST NURSING HOME",

THIRD: That except as herein altered and amended, the original partnership agreement dated November 16th, 1965, shall continue in full force and effect.

IN WITNESS WHEREOF, the parties hereto have hereunto set their hands and seals, the day and year first above written.

SENIOR PARTNER

Walker McKinney (L.S.)
WALKER MC KINNEY

JUNIOR PARTNERS

George Simpson (L.S.)
GEORGE SIMPSON

(L.S.)
THEODORE METZGER

(L.S.)
THOMAS FAILY

(Partnership Agreements, Group A)*
First Amend to Third Agreement, Name
Change (8/1/65).

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STATE OF NEW YORK
COUNTY OF ONONDAGA SS:
CITY OF SYRACUSE

On this 24 day of August, Nineteen Hundred and Sixty-Six, before me, the subscriber, personally appeared WALKER McKINNEY, GEORGE SIMPSON, THEODORE METZER AND THOMAS FAHEY, to me personally known and known to me to be the same persons described in and who executed the within Instrument, and they acknowledged to me that they executed the same.

Notary Public
Onon. Cty. 3/30/68

Exhibit A-6 — Auxiliary Partnership Agreement for Home for Adults, General Partnership (9/1/67).

CASTLE REST HOME FOR ADULTS

PARTNERSHIP AGREEMENT

AGREEMENT made as of September 1, 1967 between WALKER McKINNEY, GEORGE A. SIMPSON, THOMAS M. FAHEY and THEODORE G. METZGER.

1. Name and business. The parties do hereby organize a partnership for the operation of a proprietary home for adults licensed under the New York Social Welfare Law, which shall operate under the name of CASTLE REST HOME FOR ADULTS and which shall maintain its principal place of business at 116 East Castle Street, Syracuse, New York 13205.

2. Term. The partnership shall commence its business immediately after the execution of this Agreement and shall continue from year to year. The partnership may be terminated at any time upon the request of any partner.

3. Capital. The original capital of the partnership shall consist of $100,000 cash, to be contributed in the following percentages:

Walker McKinney - 85%
George A. Simpson - 15%
Thomas M. Fahey - -%
Theodore G. Metzger - -%

The partners, by mutual agreement, may at the end of any partnership year transfer a portion of partnership profits to the

A-6

capital of the partnership. No partner shall withdraw any part of his original or additional capital account without the consent of the other partners. The capital accounts of the partners shall be maintained in the proportions in which they share in the partnership profits and losses.

4. Profit and loss. The net losses of the partnership shall be charged to the partners in the following proportions:

Walker McKinney - 85%
George A. Simpson - 15%
Thomas M. Fahey - -%
Theodore G. Metzger - -%

The net profits of the partnership shall be distributed or credited to the drawing account of each partner as follows:

Walker McKinney - 42-1/2%
George A. Simpson - 7-1/2%

and the remaining 50% to be credited as determined by mutual agreement of the partners.

5. Salaries and drawings. No partner shall receive any salary for services rendered to the partnership. The partners shall have drawings in such amounts as may be agreed upon by them. If at the end of any partnership year, there is a debit balance in the drawing account of any partner, such partner shall, within a reasonable time, clear such debit balance by a payment to the partnership.

A-6/3

6. Interest. No interest shall be paid to any partner on his original capital, his additional capital, or his credit balance in his drawing account.

7. Management, duties and restrictions. Walker McKinney shall be the managing partner of the partnership and his decisions shall be controlling; except that no partner shall, without the consent of the others, borrow or lend money on behalf of the partnership, sell, assign or pledge his interest in the partnership, or execute any lease, mortgage or endorsement on behalf of the partnership.

8. Banking. All funds of the partnership shall be deposited in partnership bank accounts, as designated from time to time by the partners. All withdrawals from such accounts shall be made upon checks signed by any of the partners.

9. Books. The books of the partnership shall be maintained on a cash basis, and shall be closed and balanced at the end of each calendar year.

10. Death. The death of any partner shall cause a dissolution of the partnership, but the surviving partners shall have the right to continue the partnership business under its present name, provided the continuing partnership pays to the estate of the deceased partner the value of his interest in the partnership. For this purpose, the value of the interest of a deceased partner shall be the amount of his capital account, plus or minus any credit or debit balance in his drawing account, all determined as at the end of the month in which his death

A-6/5

4.

occurs in accordance with the accounting methods regularly used by the partnership, without any allowance for trade name or other intangibles (except to the extent reflected on the books of the partnership). Payment for the interest of a deceased partner shall be made to his estate in cash in three equal installments, the first within 60 days, the second within 120 days, and the third within 180 days after the end of the month in which such death occurs. Upon such payment, the estate of the deceased partner shall have no further interest in the partnership or in its business or assets. If the continuing partnership does not elect to purchase the interest of the deceased partner, the partnership shall promptly commence to wind up its affairs and shall distribute its assets in liquidation under the supervision of the surviving partners and a representative of the estate of the deceased partner. All profits and losses in liquidation shall be allocated among the surviving partners and the estate of the deceased partner in proportion to their shares of capital as set forth in Paragraph 3. In such liquidation, the partnership shall first pay all its debts, then pay credit balances in the drawing accounts of the partners, and finally distribute all other proceeds against the capital accounts of the partners.

A-6

5.

IN WITNESS WHEREOF, the parties have signed this Agreement.

Walker McKinney
Walker McKinney

George A. Simpson
George A. Simpson

Thomas M. Fahey
Thomas M. Fahey

Theodore G. Metzger
Theodore G. Metzger

(Partnership Agreements — Group A) *
Exhibit A-7 — Lease Agreement to Amend Auxiliary
Partnership Agreement of 9/--/67, General Partnership (9/--/67).

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1

Exh
A-7

September , 1967

George A. Simpson
Thomas M. Fahey
Theodore G. Metzger

Dear Sirs:

We have this day entered into a partnership agreement pursuant to which we have organized a partnership for the operation of a proprietary home for adults to be licensed under the New York Department of Social Welfare operating under the name "Castle Rest Home for Adults". This partnership agreement has been executed by us for the express purpose of facilitating the application for a license already pending before the Department of Social Welfare as originally submitted by Mr. Fahey.

It is expressly understood by all of us that the terms of this partnership agreement do not represent the final understanding of the parties as to the terms and conditions under which the partnership will be operated. As soon as possible, this agreement will be completely amended to make it as similar as possible in form and substance to the partnership agreement for the Castle Rest Nursing Home as the same now exists and as it may be amended from time to time in the future. Until such amendment takes place, the terms of the Castle Rest Nursing Home

(Partnership Agreements — Group A) *
Exhibit A-7 — Letter Agreement to Amend Auxiliary Partnership Agreement of 9/1/67, General Partnership (9/--/67).

A-7

partnership shall control our business relationship in operating the Castle Rest Home for Adults.

If the foregoing correctly expresses our understanding, please sign and return a copy of this letter to the undersigned whereupon it shall constitute a binding agreement among us.

Very truly yours,

Walker McKinney

Walker McKinney

The foregoing is hereby acknowledged and accepted:

George A. Simpson

George A. Simpson

Thomas M. Fahey

Thomas M. Fahey

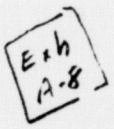
Theodore G. Metzger

Theofore G. Metzger

(Partnership Agreements — Group A) *

Exhibit A-8 — Proposed Second Amend to Third Agreement (1st draft) (partially signed). Proposed new partner, new purchase option)11/5/68).

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Proposed
2nd Amendment
(Murray's 1st Draft)
11/5/68

SECOND AMENDMENT TO PARTNERSHIP

THIS AMENDING AGREEMENT, made the 5th day of November, 1968, by and between the undersigned.

WHEREAS, the parties hereto entered into written Articles of partnership dated this 16th day of November, 1965, and;

WHEREAS, the parties hereto amended the Articles of partnership on the 1st day of August, 1966, and;

WHEREAS, the parties hereto desire to further amend said Agreement by amending Articles 3, 7 and 12 thereof;

NOW, THEREFORE, it is mutually agreed among the parties hereto as follows:

First: In Article 3.1, the name of the Junior Partner "Theodore Metzger" and his address "206 Fellows Avenue, Syracuse, New York" is stricken and the name "Jane W. McKinney" and her address "420 Mid Oak Road, N. Muskegon, Michigan" is substituted therefor.

Second: In Articles 7.3, 7.4, 12 (F.1) and Schedule A, the name of "Theodore Metzger" is stricken and the name "Jane W. McKinney" is substituted therefor.

Third: Paragraph (F.3) of ARTICLE 12 (F) is deleted, and the following new paragraph (F.3) is substituted therefor:

> "(F.3) and to such sum shall be added an additional amount so that the aggregate thereof shall equal $50,000, or the fair market value of his interest in the partnership, whichever amount is lesser.
>
> Notwithstanding the provisions of paragraph (A) of ARTICLE 12, this interest in the partnership shall first be offered for sale to the senior partner, upon the above terms and conditions."

In all other respects said Agreement is hereby ratified and confirmed.

IN WITNESS WHEREOF, the parties hereto have hereunder set

(Partnership Agreements — Group A)*
Exhibit A-8 — Proposed Second Amend to Third Agreement (1st draft) (partially signed). Proposed new partner, new purchase option (11/5/68).

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their hands and seals the day and year first above written.

SENIOR PARTNER

_____ (L.S.)
WALKER McKINNEY

JUNIOR PARTNERS

_____ (L.S.)
GEORGE SIMPSON

_____ (L.S.)
THEODORE METZGER,
Withdrawing Partner

_____ (L.S.)
THOMAS FAHEY

_____ (L.S.)
JANE W. McKINNEY,
New Partner.

STATE OF NEW YORK)
: ss.:
COUNTY OF ONANDAGA)

On the 5th day of November, Nineteen Hundred and Sixty-Eight, before me, the subscriber, personally appeared WALKER McKINNEY, GEORGE SIMPSON, THEODORE METZGER, THOMAS FAHEY and JANE W. McKINNEY to me personally known and known to me as the persons described in and who executed the within instrument, and they acknowledged to me that they executed the same.

_____
Notary Public

Partnership Agreements Group A) *

Exhibit A-9 — Proposed Second Amend to Third Agreement (2nd draft) (partially signed). Proposed new partner (1/5/69).

Ex (5) 9K 10/31/69

A-9/1

1/5/69

Exh A-9

AMENDMENT

TO

ARTICLES OF PARTNERSHIP

OF

CASTLE REST NURSING HOME

WHEREAS, ARTICLE 12 of the Articles of Partnership, dated November 16, 1965, as amended, provides for the withdrawal of a Junior Partner upon ninety (90) days notice in writing and the purchase by the Partnership of said Partner's interest in the amount determined in Paragraphs (C), (D), (E) and (F) of said ARTICLE 12, and

WHEREAS, THEODORE G. METZGER under date of September 16, 1968, has given said notice to the Partnership of his desire to withdraw and to sell his interest either to the Partnership or to another individual acceptable to said Partnership in the event said Partnership did not wish to purchase his interest, and

WHEREAS, said Partnership has determined that it does not wish to purchase said interest, and

WHEREAS, JANE W. McKINNEY has been offered the opportunity by said Partnership to acquire said interests of THEODORE B. METZGER, and to become a Partner in his place and stead, and

WHEREAS, THEODORE G. METZGER has agreed to a waiver of the valuation provisions set forth in Paragraphs (C), (D), (E) and (F), of ARTICLE 12, and to accept the sum of TWENTY-FIVE THOUSAND and no/100 DOLLARS ($25,000) directly payable to him by JANE W. McKINNEY, and

WHEREAS, such arrangement has been approved by said

(Partnership Agreements — Group A)*
Exhibit A-9 — Proposed Second Amend to Third Agreement
(2nd draft) (partially signed), Proposed new partner (1/5/69).

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Partnership.

NOW, THEREFORE, this Agreement

W I T N E S S E T H :

1. THEODORE G. METZGER by this Agreement does withdraw as a Partner of CASTLE REST NURSING HOME, waives the provisions of ARTICLE 12 with respect to valuation of his interests and does, effective this date, sell, convey, assign and transfer all of his right, title and interests as they appear in the Partnership operating under the name of CASTLE REST NURSING HOME as set forth in Articles of Partnership dated November 16, 1965, as amended; in a partnership operating under the name of "Castle Rest Nursing Home for Adults" as set forth in a partnership agreement dated September 19, 1967; in 116 East Castle Corporation and in the principal partnership property known as Castle Rest Nursing Home, 116 East Castle Street, Syracuse, New York, all of the foregoing hereinafter to be referred to collectively as the "Nursing Home";

2. The Partnership does hereby agree to the withdrawal of THEODORE G. METZGER, and substitution of JANE W. McKINNEY in his place and stead with all of the rights and privileges formerly agreed to with THEODORE G. METZGER;

3. JANE W. McKINNEY does hereby replace said THEODORE G. METZGER, and does join said Partnership with all of his rights and privileges subject to all of his liabilities and does furthermore exonerate, indemnify and hold harmless THEODORE G. METZGER from and against any and all loss, cost, claims, liabilities, obligations and judgments including, but not limited to, those relating to property damage and personal injury (including

(Partnership Agreements — Group A) *
Exhibit A-9 — Proposed Second Amend to Third Agreement
(2nd draft) (partially signed). Proposed new partner (1/5/69).

A-9/3

death), related to, arising from or in connection with THEODORE G. METZGER's right, title and interest in the Nursing Home and does further agree to accept substitution (and to execute documents necessary for such substitution) for and in the place of THEODORE G. METZGER as a partner in the Nursing Home including substitution for THEODORE G. METZGER on any debt instruments executed by THEODORE G. METZGER for and on behalf of the Nursing Home; and

4. The parties agree that this instrument of sale, conveyance, assignment and transfer shall be contingent upon acceptance of the terms and conditions of this Agreement by WALKER McKINNEY, Senior Partner of the Nursing Home, with such acceptance to be evidenced by countersignature on this Agreement as provided below.

IN WITNESS WHEREOF, the parties have set their hands and seals this day of January, 1969.

Walker McKinney
WALKER McKINNEY

Theodore G. Metzger
THEODORE G. METZGER

THOMAS FAHEY

GEORGE SIMPSON

Accepted, January , 1969, JANE W. McKINNEY

Walker McKinney
WALKER McKINNEY

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2

STATE OF NEW YORK)
: ss.:
COUNTY OF NEW YORK)

On this 10th day of January, 1969, before me, the subscriber, personally appeared WALKER McKINNEY and THEODORE G. METZGER, to me personally known and known to me to be the same persons described in and who executed the within instrument, and they acknowledged to me that they executed the same.

GENEVIEVE GRANGE
Notary Public, State of New York
No. 31-1[illegible] in New York County
Commission Expires March 30, 1969

Genevieve Grange
Notary Public

STATE OF NEW YORK)
: ss.:
COUNTY OF)

GENEVIEVE GRANGE
Notary Public, State of New York
No. 31-[illegible] in New York County
Commission Expires March 30, 1969

On this day of January, 1969, before me, the subscriber, personally appeared THOMAS FAHEY, to me personally known and known to me to be the same person described in and who executed the within instrument, and he acknowledged to me that he executed the same.

Notary Public

STATE OF)
: ss.:
COUNTY OF)

On this day of January, 1969, before me, the subscriber, personally appeared GEORGE SIMPSON, to me personally known and known to me to be the same person described in and who executed the within instrument, and he acknowledged to me that he executed the same.

Notary Public

(Partnership Agreements — Group A) *
Exhibit A-9 — Proposed Second Amend to Third Agreement
(2nd draft) (partially signed). Proposed new partner (1/5/69).

A 9
5

STATE OF)
: ss.:
COUNTY OF)

On this day of January, 1969, before me, the subscriber, personally appeared JANE W. McKINNEY, to me personally known and known to me to be the same person described in and who executed the within instrument, and she acknowledged to me that she executed the same.

Notary Public

(Partnership Agreements — Group A) *
Exhibit A-10 — Purchase Agreement Between Partners, Fahey
Purchase of Simpson Interest (3/12/69).

WW

P.

3/12/69

Exh A-10

CONVEYANCE OF INTEREST OF GEORGE SIMPSON

TO THOMAS FAHEY

THIS AGREEMENT made the 12th day of March, 1969 getween THOMAS FAHEY and GEORGE SIMPSON.

W I T N E S S E T H

WHEREAS, the parties hereto have been since the 16th day of November, 1965, and prior thereto, partners under a certain "ARTICLES OF PARTNERSHIP OF CASTLE REST NURSING HOME" operating as "Castle Rest Nursing Home"; and partners under a certain "CASTLE REST HOME FOR ADULTS PARTNERSHIP AGREEMENT" dated September 1, 1967 and related to the Castle Rest Nursing Home by letter agreement dated September, 1967; and in the "116 East Castle Corporation" (all of which are hereinafter referred to collectively as the "Partnership"); and

WHEREAS, the said GEORGE SIMPSON desires to sell his entire share and interest in the Partnership to the said THOMAS FAHEY; and

WHEREAS, the parties hereto have agreed that the sum of $48,750.00 is a fair valuation of GEORGE SIMPSON's share and interest and THOMAS FAHEY has agreed to pay to GEORGE SIMPSON, the sum of $48,750.00 in satisfaction of and in full payment for his share and interest.

W I T N E S S E T H

That in consideration of tne premises and the payment of the sum of $48,750.00 by THOMAS FAHEY to GEORGE SIMPSON, the receipt of which is hereby acknowledged, the said GEORGE SIMPSON does hereby sell, transfer, release, grant and assign to THOMAS FAHEY, his heirs, executors,

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administrators and assigns, his entire share and interest in and to said Partnership, to have and to hold to the said THOMAS FAHEY, his heirs, executors, administrators or assigns. The said GEORGE SIMPSON hereby agrees to sign and execute any additional assignments or instruments as may be necessary or become necessary to effectuate this agreement and conveyance.

IN WITNESS WHEREOF, I have hereunto set my hand and seal this 12th day of March, 1969.

George Simpson
GEORGE SIMPSON

STATE OF NEW YORK)
COUNTY OF New York) : ss.:

On March 12, 1969 before me personally came GEORGE SIMPSON, to me known and known to me to be the individual described in and who executed the foregoing instrument, and duly acknowledged to me that he executed the same.

Robert A. Damon
Notary Public

ROBERT A. [illegible]
Notary Public, State of New York
No. [illegible]
Certificate filed in [illegible] County
Commission Expires March 30, 1969

ASSUMPTION OF LIABILITIES

THOMAS FAHEY hereby assumes all of GEORGE SIMPSON's liabilities (presently existing or hereafter arising) as a partner of the Partnership.

THOMAS FAHEY agrees to indemnify and hold GEORGE SIMPSON harmless against any and all claims, demands, loss, damage, liability or expenses (including costs of suit and

A-10/3 3

reasonable attorneys' fees) related to, arising from or connected with GEORGE SIMPSON's share and interest in the Partnership.

Thomas Fahey
THOMAS FAHEY

STATE OF NEW YORK)
: ss.:
COUNTY OF New York)

On March 12, 1969, before me personally came THOMAS FAHEY, to me known and known to me to be the individual described in, and who executed the foregoing instrument, and duly acknowledged to me that he executed the same.

Robert A. Barron
Notary Public

ROBERT A. BARRON
Notary Public, State of New York
No. 60 C174775, Queens County
Certificate Filed in New York County
Commission Expires March 30, 1969

(Partnership Agreements — Group A) *
Exhibit A-10 — Purchase Agreement Between Partners, Fahey Purchase of Simpson Interest (3/12/69).

A-10/4

March 12, 1969

Mr. George A. Simpson
592 Park Avenue
East Orange, New Jersey

Dear George:

Reference is made to the document executed by us today entitled "Conveyance of Interest of George Simpson to Thomas Fahey," (herein referred to as the "Conveyance"). In order to induce you to sign the Conveyance, and in consideration of your signing the same, I agree as follows:

1. I will cause an appropriate certificate to be filed no later than April 12, 1969 with the County Clerk of Onondaga County, New York indicating that you are no longer a partner in the Partnership referred to in the Conveyance as of March 12, 1969.

2. I shall promptly use my best efforts to cause the Marine Midland Company of Central New York to remove you as a signatory on the guarantee with that bank which was executed by all of the partners in the said Partnership and to terminate all liabilities which you may have arising out of the said guarantee. Until such time as you are so removed as a signatory, your liability therein shall be a liability indemnified by me under the "Assumption of Liabilities" portion of the Conveyance.

Very truly yours,

Thomas M. Fahey

Accepted and Agreed to:

George A. Simpson

(Partnership Agreements — Group A) *
Exhibit A-11 — Proposed Second Amend to Third Agreement (3rd draft) (signed without provision for Fahey's signature), new partner Jane McKinney (3/25/69).

A-11
3/25/69
Ex. A-11

Ex (1)
GK
10/31/69

SECOND AMENDMENT

TO

ARTICLES OF PARTNERSHIP

OF

CASTLE REST NURSING HOME

WHEREAS, ARTICLE 12 of the Articles of Partnership dated November 16, 1965, as amended August 1, 1966, provides for the withdrawal of a Junior Partner upon ninety (90) days notice in writing and the purchase by the Partnership of said Partner's interest in the amount determined in Paragraphs (C), (D), (E) and (F) of said ARTICLE 12, and

WHEREAS, THEODORE G. METZGER, a Junior Partner, under date of September 16, 1968, has given said notice to the Partnership of his desire to terminate his interest in the Partnership, and

WHEREAS, WALKER McKINNEY, the Senior Partner, has decided that it is in the best interest of the Partnership for said Junior Partner to withdraw, and

WHEREAS, THEODORE G. METZGER has agreed to a waiver of the valuation provisions set forth in Paragraphs (C), (D), (E) and (F) of ARTICLE 12, and to accept the sum of TWENTY-FIVE THOUSAND and no/100 Dollars ($25,000) payable to him by the Partnership, and

WHEREAS, ARTICLE 3 of the Articles of Partnership provides that additional partners may be admitted upon such terms and conditions as shall be agreed upon by the Senior Partner, and

WHEREAS, said Senior Partner has decided to admit as an additional partner, JANE W. McKINNEY, upon the same terms and con-

(Partnership Agreements, Group A) *

Exhibit A-11 — Proposed Second Amend to Third Agreement (3rd draft) (signed without provision for Fahey's signature), new partner Jane McKinney (3/25/69).

A-11

ditions, and same benefits and liabilities as were previously enjoyed by the withdrawing Partner, THEODORE G. METZGER, upon the payment by her of a partnership contribution of TWENTY-FIVE THOUSAND and no/100 Dollars ($25,000), in order to finance the termination of partnership interest of THEODORE G. METZGER, and the assumption by her of all partnership liabilities previously endorsed by THEODORE G. METZGER.

NOW, THEREFORE, this Agreement

W I T N E S S E T H:

1. THEODORE G. METZGER, by this Agreement does terminate his interest as a Partner of CASTLE REST NURSING HOME, waives the provisions of ARTICLE 12 with respect to valuation of his interest and does, effective this date, accept the sum of TWENTY-FIVE THOUSAND and no/100 Dollars ($25,000) in full payment for all of his right, title and interests as they appear in the Partnership operating under the name of CASTLE REST NURSING HOME as set forth in Articles of Partnership dated November 16, 1965, as amended August 1, 1966; in a partnership operating under the name of "Castle Rest Nursing Home for Adults" as set forth in a Partnership Agreement dated September 19, 1967; in 116 East Castle Corporation and in the principal partnership property known as Castle Rest Nursing Home, 116 East Castle Street, Syracuse, New York, all of the foregoing hereinafter to be referred to collectively as the "Nursing Home";

2. The Senior Partner does hereby agree to the termination of interest of THEODORE G. METZGER, and admission of JANE W. McKINNEY as an additional Partner subject to all of the terms and conditions and same benefits and liabilities as were formerly held by THEODORE G. METZGER;

(Partnership Agreements, Group A) *
Exhibit A-11 — Proposed Second Amend to Third Agreement
(3rd draft) (signed without provision for Fahey's signature)
new partner Jane McKinney (3/25/69)

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3. JANE W. McKINNEY does hereby join said Partnership upon the same terms and conditions and subject to all of the liabilities formerly held by THEODORE G. METZGER, and does furthermore exonerate, indemnify and hold harmless THEODORE G. METZGER from and against any and all loss, cost, claims, liabilities, obligations and judgments including, but not limited to, those relating to property damage and personal injury (including death), related to, arising from or in connection with THEODORE G. METZGER's right, title and interest in the Nursing Home and does further agree to accept substitution (and to execute documents necessary for such substitution) for and in the place of THEODORE G. METZGER as a Partner in the Nursing Home including substitution for THEODORE G. METZGER on any debt instruments executed by THEODORE G. METZGER for and on behalf of the Nursing Home; and

4. The parties agree that this instrument of termination and admission of an additional partner shall be contingent upon acceptance of the terms and conditions of this Agreement by WALKER McKINNEY, Senior Partner of the Nursing Home, with such acceptance to be evidenced by countersignature on this Agreement as provided below.

5. The parties further agree as follows:

First: In Article 3.1, the name of the Junior Partner "Theodore Metzger" and his address "206 Fellows Avenue, Syracuse, New York" is stricken and the name "Jane W. McKinney" and her address "420 Mid Oak Road, N. Muskegon, Michigan" is substituted therefor.

Second: In Articles 7.3, 7.4, 12 (F.1) and Schedule A, the name of "Theodore Metzger" is stricken and the name "Jane W. McKinney" is substituted therefor, and in Schedule A, the capital contribution of 2,000 opposite the name of "Theodore Metzger" is stricken and the sum of $25,000 is substituted therefor.

IN WITNESS WHEREOF, the parties have set their hands

(Partnership Agreements, Group A) *
Exhibit A-11 — Proposed Second Amend to Third Agreement (3rd draft) (signed without provision for Fahey's signature). new partner Jane McKinney (3/25/69).

A-11

and seals this 25th day of March, 1969.

THEODORE G. METZGER

JANE W. McKINNEY

Accepted March 25th, 1969,

WALKER McKINNEY,
Senior Partner

(Partnership Agreements, Group A) *
Exhibit A-11 — Proposed Second Amend to Third Agreement (3rd draft) (signed without provision for Fahey's signature), new partner Jane McKinney (3/25/69).

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STATE OF NEW YORK)
: ss.:
COUNTY OF NEW YORK)

On this 25th day of March, 1969, before me, the subscriber, personally appeared WALKER McKINNEY, to me personally known and known to me to be the same person described in and who executed the within instrument, and he acknowledged to me that he executed the same.

Hazel M. Falk

HAZEL M. FALK
NOTARY PUBLIC, State of New York
No. 31-0216235
Qualified in New York County
Commission Expires March 30, 1970

STATE OF NEW YORK)
: ss.:
COUNTY OF NEW YORK)

On this 25th day of March, 1969, before me, the subscriber, personally appeared THEODORE G. METZGER, to me personally known and known to me to be the same person described in and who executed the within instrument, and he acknowledged to me that he executed the same.

Hazel M. Falk

HAZEL M. FALK
NOTARY PUBLIC, State of New York
No. 31-0216235
Qualified in New York County
Commission Expires March 30, 1970

STATE OF MICHIGAN)
: ss.:
COUNTY OF)

On this 31 day of March, 1969, before me, the subscriber, personally appeared JANE W. McKINNEY, to me personally known and known to me to be the same person described in and who executed the within instrument, and she acknowledged to me that she executed the same.

Jane F. McKinney

Notary [illegible] Mich.
My Commission Expires May 4, 1970

(Partnership Litigation — Group B) *
Index to Group B.

Re U.S. v. Thomas Fahey

B

GROUP B

Motion Papers Re Litigation
Court and Arbitration

EXHIBIT				
B-1	6/ 3/69	MOVING PAPERS (McKinney)	EX PARTE INJUNCTION	15
B-2	6/ 3/69	LETTER (McKinney)	MCKINNEY ATTEMPT TO EXPELL AND DISMISS FAHEY	4
B-3	6/20/69	DECISION (Aronson)	REFER DISPUTE TO ARBITRATION: DENY RESTRAINING ORDER	7
B-4	6/21/69	LETTER (McKinney)	MCKINNEY ATTEMPT TO BUY OUT FAHEY	1
B-5	6/23/69	ORDER DRAFT (Lawton for Aronson)		4
B-6	6/23/69	ORDER (Aronson	REFER DISPUTE TO ARBITRATION: GROUNDRULES FOR INTERIM OPERATIONS	4
B-7	9/ 8/70	ARBITRATION AWARD		3
B-8	10/ 1/70	MOTION (Fahey)	TO CONFIRM ARBITRATION AWARD	2
B-9	10/ 9/70	CROSS-MOTION (McKinney)	TO VACATE OR MODIFY AWARD	19
	1/ 6/71	DECISION (Aronson)	MODIFYING AWARD	9
B-11	6/ 7/71	LETTER (Kemple)	ORDER DRAFT	1
B-12	2/16/72	ORDER (Aronson)	MODIFYING AWARD	3
B-13	3/ /72	NOTICE OF APPEAL (Fahey)		2
B-14	3/20/72	CROSS-NOTICE OF APPEAL (McKinney)		1
B-15	BRIEF	Millet v. Slocum 4 AD 2d 528, Aff'd 5 NY 2d 734 (1957). Partners cannot, as a matter of law, either expel a co-partner or compel him to resign or withdraw, on the ground that it is in the best interest of the partnership.		11
B-16	NOTES	SEE NOTES RE ANOTHER ALTERNATIVE TO A STRAIGHT APPEAL TO OVERRULE ARONSON AND CONFIRM AWARD (which opposition has stated they would take to Court of Appeals). The object would be to affirm Fahey's continuing status as a partner and tie up assets of Castle Rest Nursing Home from dissipation by McKinney.		7

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(Partnership Litigation — Group B) *
Exhibit B-1 — Moving Papers (McKinney), Ex Parte Injunction (6/3/69).

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C 106 - Summons with Notice, Blank Court
Personal or Substituted Service R 65

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80 EXCHANGE PLACE AT BROADWAY, NEW YORK

SUPREME COURT
STATE OF NEW YORK COUNTY OF ONONDAGA

Index No.

Plaintiff designates Onondaga *County as the place of trial*

The basis of the venue is
Residence of plaintiff

CASTLE REST NURSING HOME and WALKER McKINNEY,

Plaintiffs

against

THOMAS FAHEY,

Defendant

Summons with Notice

Plaintiff ~~xxxxxxx~~ Castle Rest Nursing Home has principal place of business in *County of* Onondaga, N.Y.

To the above named Defendant

You are hereby summoned *to answer the complaint in this action and to serve a copy of your answer, or, if the complaint is not served with this summons, to serve a notice of appearance, on the Plaintiff's Attorney(s) within* 20 *days after the service of this summons, exclusive of the day of service (or within 30 days after the service is complete if this summons is not personally delivered to you within the State of New York); and in case of your failure to appear or answer, judgment will be taken against you by default for the relief demanded in the complaint.*

Dated, May 29, 1969

HANCOCK, RYAN, SHOVE & HUST
Attorney(s) for Plaintiff
Office and Post Office Address
One Mony Plaza
Syracuse, New York 13202
(315) 471-3151

Notice: The object of this action is
Accounting and Injunction

The relief sought is

Upon your failure to appear, judgment will be taken against you by default for the sum of $ with interest from 19 and the costs of this action.

Summons

(Partnership Litigation — Group B) *
Exhibit B-1 — Moving Papers (McKinney), Ex Parte Injunction
(6/3/69).

B/N 6/2/69

At a Special Term of the Supreme Court of the State of New York held in and for the County of Onondaga at the County Court House, City of Syracuse, New York on the 2nd day of June, 1969.

PRESENT: Hon. Edward Cannon

Justice of Supreme Court

STATE OF NEW YORK
SUPREME COURT COUNTY OF ONONDAGA

CASTLE REST NURSING HOME and WALKER McKINNEY,

Plaintiffs,

-against-

THOMAS FAHEY,

Defendant.

ORDER TO SHOW CAUSE.

Index No. 69-3154

On the affidavit of Walker McKinney, sworn to the 29th day of May, 1969, the summons and complaint in this action, and the bond and undertaking of Fidelity and Deposit Company of Maryland, dated June 2nd, 1969,

LET defendant Thomas Fahey show cause at a Special Term of this Court to be held in and for the County of Onondaga at the County Court House in the City of Syracuse, New York on June 10, 1969 at 10:00 in the forenoon of that day or as soon thereafter as counsel can be heard, why an order should not be made herein directing that plaintiff Walker McKinney continue and have exclusive management of the business now carried on by the partnership plaintiff Castle Rest Nursing Home, and further directing that plaintiff Walker McKinney have exclusive possession of all property, goods and assets of the partnership of Castle Rest Nursing Home, together with the books, records and papers of said firm, and restraining defendant Thomas Fahey from interfering in any way with the

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operation and management of the business of said partnership or from interfering in any way with the assets, employees or good will of said partnership, and for such other and further relief as may be equitable; and it is further

ORDERED, pending the hearing and determination of the within application, that defendant Thomas Fahey be, and he hereby is, enjoined from interfering in any way with the operation and management of the partnership of plaintiff Castle Rest Nursing Home, from going upon the real property on which said Castle Rest Nursing Home is located, or from interfering in any way with the property, assets, employees or business reputation of plaintiff Castle Rest Nursing Home; and it is further

ORDERED, pending the hearing and determination of the within application, that plaintiff Walker McKinney continue and have exclusive management of the business now carried on by the partnership of plaintiff Castle Rest Nursing Home; and it is further

ORDERED, pending the hearing and determination of the within application, that plaintiff Walker McKinney have exclusive possession of the property, goods, and assets of the partnership of Castle Rest Nursing Home, together with the books, records and papers of said partnership; and it is further

ORDERED that the bond and undertaking of Fidelity and Deposit Company of Maryland in the amount of $75,000.00 be and hereby is determined to be sufficient and adequate as to amount and form; and it is further

ORDERED that sufficient cause having been shown therefor, personal service of this order to show cause, together with the papers on which it has been granted, upon

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J

defendant Thomas Fahey on or before June 5, 1969, be determined good and sufficient service thereof.

Dated at Syracuse, New York this 2nd day of June, 1969.

ENTER

Justice of Supreme Court

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SUPREME COURT
STATE OF NEW YORK COUNTY OF ONONDAGA

CASTLE REST NURSING HOME and WALKER McKINNEY, Plaintiffs, -against- THOMAS FAHEY, Defendant.	COMPLAINT

Plaintiffs Castle Rest Nursing Home and Walker McKinney, by their attorneys, Hancock, Ryan, Shove & Hust, for their complaint in the above entitled action, allege:

FIRST: Castle Rest Nursing Home is a partnership, formed pursuant to Articles of Partnership, as amended, which conducts and operates a nursing home in the City of Syracuse, County of Onondaga, New York.

SECOND: Plaintiff Walker McKinney is senior partner of plaintiff Castle Rest Nursing Home, and resides in the County of New York, State of New York.

THIRD: Defendant Thomas Fahey was heretofore junior partner of plaintiff Castle Rest Nursing Home, and resides in the County of Onondaga, State of New York.

FOURTH: Pursuant to the Articles of Partnership, as amended, plaintiff Walker McKinney as senior partner, is vested with the right to make all decisions with regard to all actions taken by the partnership, and all questions of policy, judgment, management and discretion and any other questions relative to the business of the partnership.

FIFTH: Defendant Thomas Fahey has wrongfully excluded plaintiff Walker McKinney from the partnership business and fro[m]

cont'd.

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possession of the partnership property, and has refused to allow plaintiff Walker McKinney to participate in and to manage the partnership business.

SIXTH: Defendant Thomas Fahey has failed and refused to acknowledge or follow the decisions and instructions of plaintiff Walker McKinney as senior partner, and has ignored said decisions and instructions, has been insubordinate and has assumed and exercised control over the business of the partnership in excess of the authority vested in him by the partnership or by the Articles of Partnership, as amended.

SEVENTH: Pursuant to the Articles of Partnership, as amended, a junior partner who violates the Articles of Partnership, as amended, or who is guilty of conduct which tends to affect adversely the carrying on of the business of the partnership, or conducts himself in matters relating to the partnership business so that it is not reasonably practicable to carry on the business of the partnership with him, ceases to be a partner upon receipt of written notice.

EIGHTH: Defendant Thomas Fahey has violated the Articles of Partnership, as aforesaid, and has so conducted himself as to adversely affect the carrying on of the business of the partnership and as to render it impossible to carry on the business of the partnership with said defendant Thomas Fahey.

WHEREFORE, plaintiffs demand judgment;

1. That defendant Thomas Fahey account for all his

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acts and proceedings with regard to all partnership transactions and of the moneys received and paid by defendant in relation thereto, and on the property thereof.

2. That it be declared that defendant Thomas Fahey has ceased to be a partner of plaintiff Castle Rest Nursing Home, and that his partnership interest is terminated.

3. That defendant Thomas Fahey be enjoined from interfering with the operation and management of plaintiff Castle Rest Nursing Home, its assets, employees or good will.

4. That plaintiffs have such other and further relief as may be just and proper, together with the costs and disbursements of this action.

HANCOCK, RYAN, SHOVE & HUST
Attorneys for Plaintiffs
Walker McKinney and Castle Rest
Nursing Home
Office and Post Office Address
One Mony Plaza
Syracuse, New York 13202
(315) 471-3151

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STATE OF NEW YORK

SUPREME COURT COUNTY OF ONONDAGA

CASTLE REST NURSING HOME and WALKER McKINNEY, Plaintiffs, - against - THOMAS FAHEY, Defendant.	AFFIDAVIT

STATE OF NEW YORK)
)
COUNTY OF NEW YORK) SS.:

WALKER McKINNEY, being duly sworn, deposes and says:

1: I reside at 47 East 87th Street, New York, New York, and I am one of the plaintiffs in the above entitled action.

2: Castle Rest Nursing Home is a partnership formed pursuant to Articles of Partnership dated November 15, 1965, as amended.

3: The purpose of said partnership is the ownership and operation of a nursing home in the City of Syracuse, New York known as Castle Rest Nursing Home, which is located at 116 East Castle Street, and the partnership now owns and operates said Castle Rest Nursing Home.

4: The partnership consists of deponent as senior partner, and junior partners, one of whom is defendant Thomas Fahey, who is also administrator of Castle Rest Nursing Home.

5: Pursuant to the terms of said partnership agreement, defendant Thomas Fahey, after a return of a portion of capital account of plaintiff Walker McKinney, is entitled to 90% of the profits of said partnership.

6: Deponent, however, as senior partner, is chargeable with 85% of all net losses, while defendant Fahey is not chargeable with net losses of the partnership.

McKINNEY 29 pp.
AFFIDAVIT

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7: Deponent has provided 85% of the investment in said Castle Rest Nursing Home, in an aggregate in excess of $300,000 while defendant Thomas Fahey has made no contribution to the capital of said partnership.

8: The aforesaid Articles of Partnership vest with deponent as senior partner the right to make all decisions with regard to all actions taken by the partnership, and all questions of policy, judgment, management and discretion or any other questions relative to the business of the partnership.

9: The Articles of Partnership further provide that a junior partner, such as defendant Thomas Fahey, may not increase his interest in the partnership without consent of deponent as senior partner.

10: Defendant Thomas Fahey, on or about April 1, 1969, purportedly acquired the interest of another junior partner in an attempt to increase his interest and control in the partnership, all without permission of deponent as senior partner.

11: In violation of the Articles of Partnership, defendant Thomas Fahey maintained that he was in a position of equality with deponent and that he could withhold payments of funds of the partnership from deponent.

12: Defendant Thomas Fahey failed and refused to carry out the decision of the deponent as senior partner that all checks of the partnership be signed by both deponent and defendant Thomas Fahey.

13: Defendant Thomas Fahey has also refused to honor decision by deponent as senior partner that defendant Fahey furnish deponent with weekly reports regarding the operation of the Castle Rest Nursing Home.

14: Defendant Thomas Fahey has further refused to consult with deponent with regard to expenditures of partnership funds and on the conduct of partnership affairs and defendant Thomas Fahey has further dissipated partnership funds by hiring a consulting firm on a yearly contract, paying over thirty thousand dollars, which exceeds the yearly salary of defendant Thomas Fahey, and defendant has further refused to follow the decision of deponent as senior partner, and has, in violation of his instructions and

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and orders, extended the aforesaid contract with the consulting firm for an additional year.

15: Defendant Thomas Fahey has further failed and refused to meet with deponent and has refused to communicate with deponent, has acted as an equal partner and has, in fact, conducted the business of the Castle Rest Nursing Home as if the same were a sole proprietorship.

16: Defendant Thomas Fahey has, as aforesaid, refused to comply with the Articles of Partnership and with the decisions of the senior partner, has been insubordinate and has assumed and exercised control over the business of the partnership in excess of the authority vested in him.

17: The Articles of Partnership provide that a junior partner, such as defendant Thomas Fahey, ceases to be a partner if he should violate the provisions of the Articles of Partnership or should be guilty of conduct as tends to affect adversely the carrying on of the business of the partnership or shall conduct himself in matters relating to the partnership business so that it is not reasonably practicable to carry on the business of the partnership with him.

18: As set forth above, defendant Thomas Fahey has violated the Articles of Partnership by attempting to increase his interest in said partnership without permission of the senior partner, and by his insubordination and failure to observe those provisions of the partnership vesting management thereof in the senior partner.

19: As set forth herein, the conduct of defendant Thomas Fahey has created an impasse which makes it impossible to carry on the business of the partnership with him, and his conduct has further been such that it has adversely affected the continuance of the business of the partnership.

20: Pursuant to the Articles of Partnership, defendant Thomas Fahey shall, upon service on him of written notice, cease to be a partner in plaintiff Castle Rest Nursing Home.

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21: In addition thereto, the status of defendant Thomas Fahey as partner may be terminated by deponent as senior partner upon the decision of deponent that such termination is for the best interest of the partnership.

22: With the service of notice terminating the interest of defendant Thomas Fahey in the partnership, the above entitled action is brought to enforce the Articles of Partnership, insuring deponent's management thereof, enforcing the expulsion of defendant Thomas Fahey as partner, restraining his interference with partnership property and business, and requiring that he account for all dealings and transactions with and on behalf of the partnership.

23: There are in the aforesaid Castle Rest Nursing Home approximately one hundredfifty patients, who are invalids, sick, infirm and disabled, requiring nursing, hygenic and bedside care.

24: From the time of the termination of defendant Thomas Fahey as partner, and during the pendency of the aforesaid action, it will be necessary to insure the continued care of patients and the retention of key personnel at Castle Rest Nursing Home, such as supervisors, staff, nurses, and dietitions.

25: From a proprietary aspect, the good will and reputation of Castle Rest Nursing Home and the retention and protection of the assets of the partnership are necessary during this period of transition.

26: Upon information and belief, and in view of the past conduct and attitudes of defendant Thomas Fahey in exercising complete control of the affairs of the partnership, excluding deponent therefrom, defendant Thomas Fahey will be in a position to disrupt operation of the Castle Rest Nursing Home by refusing to vacate his position as administrato: and by disputing the termination of his partnership, and can cause discontent and dissent among, and, in fact, loss of service of, employees, particularly supervisory staff, and nursing personnel so necessary to continue operations and to insure the orderly and efficient care of the patients now at Castle Rest Nursing Home.

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27: Upon information and belief, since it is essential that the business of the partnership and of the operation of Castle Rest Nursing Home be carried on in an orderly fashion, the assets and good will of the partnership and Castle Rest Nursing Home will be lost if said operation is in any manner disrupted.

28: Pursuant to Articles of Partnership whereby the management of the partnership reposes in deponent as senior partner, deponent has secured the services of Francis J. McCarthy, Jr., who will become administrator of Castle Rest Nursing Home.

29: Mr. McCarthy has received his Master of Public Administration from the Sloan Institute of Hospital Administration at Cornell University and until this date has been administrator of Coney Island Hospital, an affiliate of Maimonides Medical Center. In this capacity, he has been responsible for the proprietary, fiscal and personnel matters necessary for the operation of a 471 bed general hospital and, in addition, a psychiatry service and extended care program involving one hundred beds.

30: Prior to such employment, Mr. McCarthy was administrator of Strang Clinic, the largest cancer detection center in the country; in that capacity, he had coordinated all activities of the clinic and supervised construction of the clinic from conception to completion.

31: Upon information and belief, Mr. McCarthy has the experience, background, ability, and characteristics including the tact and disposition necessary to coordinate and manage the sensitive areas and phases of health center operation, insuring essential medical and health services to patients, while providing a profitable and successful business operation.

32: Deponent believes that unless he is permitted to continue the business and exclusive management of plaintiff partnership, Castle Rest Nursing Home, as provided in the Partnership Agreement, the well - being of patients at the Nursing Home will be endangered, along with the assets and good will of the partnership.

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33: This continued operation of the partnership business, and of the Castle Rest Nursing Home during the pendency of this action, and upon termination of defendant Thomas Fahey's interest in the partnership, will be achieved by the exclusive management and operation of the business by deponent, with Mr. McCarthy as administrator, and the preservation of the assets and good will of the partnership can be accomplished, thereby avoiding the necessity of appointment of a receiver, who would be unfamiliar with the operation of the partnership.

34: No previous application has been made for the relief sought herein.

WHEREFORE, deponent requests an order:

1. Directing plaintiff Walker McKinney continue the business now carried on by the partnership of Castle Rest Nursing Home, and further directing that plaintiff Walker McKinney have exclusive management of said business.

2. That plaintiff Walker McKinney have exclusive possession of property, goods and assets of the firm of Castle Rest Nursing Home, together with the books, records, and papers of said firm.

3. Restraining defendant Thomas Fahey from interfering in any way with the assets or good will of the business of the partnership of Castle Rest Nursing Home, or from interfering in any way with the employees of or conduct of the business of said partnership.

Walker McKinney

Sworn to before me this 29th day of May 1969.

Vincent A. Stabile
Notary Public

VINCENT A. STABILE
[illegible] State of New York
[illegible]
[illegible] County
[illegible] County Clerk
Commission Expires March 30, 1971

(Partnership Litigation — Group B) *
Exhibit B-1 — Moving Papers (McKinney), Ex Parte Injunction
(6/3/69).

Fidelity and Deposit Company

HOME OFFICE OF MARYLAND BALTIMORE 3

STATE OF NEW YORK
SUPREME COURT COUNTY OF ONONDAGA

CASTLE REST NURSING HOME and
WALKER McKINNEY,

Plaintiff

-against- UNDERTAKING

THOMAS FAHEY,

Defendant

WHEREAS, an action is about to be commenced in Supreme Court, Onondaga County, wherein Walker McKinney is one of the plaintiffs and Thomas Fahey is defendant, effecting the continued prosecution of the business of the partnership of plaintiff Castle Rest Nursing Home; and

WHEREAS, an application is about to be made by plaintiff Walker McKinney pursuant to Partnership Law, Section 75, for an order directing that plaintiff Walker McKinney continue the business and exercise exclusive management over the operations of the partnership of plaintiff Castle Rest Nursing Home, and further directing that plaintiff Walker McKinney have exclusive possession of all property, goods, assets of plaintiff Castle Rest Nursing Home, together with the books, records and papers of said firm during the pendency of said action; and

WHEREAS, plaintiff Walker McKinney is about to make application for an order temporarily restraining defendant Thomas Fahey from interfering with the operation and management of plaintiff Castle Rest Nursing Home, and from interfering with the assets, employees, or good will of plaintiff Castle Rest Nursing Home;

NOW, THEREFORE, FIDELITY AND DEPOSIT COMPANY OF MARYLAND, having an office and principal place of business at 1405 State Tower Building, Syracuse, New York, is hereby held and firmly bound unto defendant Thomas Fahey in the sum of Seventy-five Thousand Dollars ($75,000.00) to be paid the said defendant Thomas Fahey, to which payment well and truly to be made the undersigned binds itself, its successors and assigns, by these presents;

NOW, THEREFORE, the condition of this undertaking is such that if plaintiff Walker McKinney shall obey all orders of this Court in this action and perform all things which the judgment herein may require him to perform, then this obligation shall be void; otherwise to remain in full force and effect;

NOW, THEREFORE, Fidelity and Deposit Company of Maryland does hereby, pursuant to the statutes in such cases, undertake that plaintiff Walker McKinney, if it is finally determined that said plaintiff Walker McKinney was not entitled to an injunction, will pay to the defendant Thomas Fahey all damages and costs which may be sustained by reason of said temporary restraining order, not exceeding the sum of Seventy-five Thousand Dollars ($75,000.00).

Dated, June 2, 1969

FIDELITY AND DEPOSIT COMPANY OF MARYLAND

By _____

Fidelity and Deposit Company

HOME OFFICE OF MARYLAND BALTIMORE, MD. 21203

STATE OF NEW YORK
COUNTY OF ONONDAGA } ss:

On the 2nd day of June 19 69, before me personally came Harold D. Rarrick, to me known, who being by me duly sworn, did depose and say, that he resides at Syracuse, in the County of Onondaga, State of New York; that he is Attorney-in-Fact of the Fidelity and Deposit Company of Maryland, the corporation described in and which executed the within instrument, that he knows the corporate seal of said corporation; that the seal affixed to said instrument is such corporate seal, that it was so affixed by order of the Board of Directors of said corporation, and that he signed his name thereto by like order; and that the Fidelity and Deposit Company of Maryland is duly authorized to transact business in the State of New York in pursuance of the statutes in such case made and provided; that the Superintendent of Insurance of the State of New York has, pursuant to Chapter 28 of the Consolidated Laws of the State of New York, known as the Insurance Law, issued to the Fidelity and Deposit Company of Maryland a Certificate of Solvency and of qualification to become surety or guarantor on all bonds, undertakings, recognizances, guaranties and other obligations required or permitted by law, and that such certificate has not been revoked.

JUNE H. CLARKE
Notary Public in the State of New York
Qualified in Onon. Co. No. 31-5213450
My Commission Expires March 30, 1972

June H. Clarke
Notary Public

At a regular meeting of the Executive Committee of the Board of Directors of the Fidelity and Deposit Company of Maryland, held at its office in the City of Baltimore, State of Maryland, on the 4th day of April, 1968, the following Resolution was unanimously adopted:

"RESOLVED, That Harold D. Rarrick, John C. Naatz, and Richard F. Yeazel, of the City of Syracuse, State of New York, be, and each of them is hereby appointed Attorney-in-Fact of this Company in the State of New York, and authorized and empowered to execute and deliver any and all bonds and undertakings, also to perform any and all acts for or on behalf of this Company in its business of guaranteeing the fidelity of persons holding places of public or private trust and the performance of contracts other than insurance policies, and executing and guaranteeing bonds, or other undertakings required or permitted in all actions or proceedings or by law required, and to attach thereto the seal of the Company; also to execute and deliver waivers of citation or notices of appearance for or on behalf of said Company, in any proceeding in any Court to which said Company may be a party.

"RESOLVED FURTHER, That June H. Clarke, of the City of Syracuse, State of New York, is hereby appointed Attorney-in-Fact of this Company and authorized and empowered to execute and deliver any and all bonds and undertakings, also to perform any and all acts for and in behalf of this Company in its business of guaranteeing the fidelity of persons holding places of public or private trust and the performance of contracts, other than insurance policies, and executing and guaranteeing bonds or other undertakings required or permitted in all actions or proceedings, or by law required, the penalty of each of said bonds and undertakings not to exceed the sum of Two HUNDRED FIFTY THOUSAND DOLLARS ($250,000) and to attach thereto the seal of the Company; also to execute and deliver waivers of citation or notices of appearance for or on behalf of said Company in any proceeding in any Court to which said Company may be a party.

"AND BE IT FURTHER RESOLVED, That the above named Attorneys-in-Fact are, and each of them is, further authorized and empowered to certify under the seal of this Company to this Resolution within the limits hereinbefore specifically prescribed for each.

"This Resolution revokes that of June 15, 1966 on behalf of Harold D. Rarrick, John C. Naatz and June H. Clarke, and Power of Attorney issued December 28, 1967 on behalf of Richard F. Yeazel."

I, J. J. MOORE, of the Fidelity and Deposit Company of Maryland have compared the foregoing Resolution with the original thereof, as recorded in the Minute Book of said Company and Do Hereby Certify that the same is a true and correct transcript therefrom, and of the whole of said original Resolution, and that the authority granted to the individuals specified in said Resolution of April 4, 1968, is in full force and unrevoked as of this date.

Given under my hand and the seal of the Company, at the City of Syracuse, New York this 2nd day of June 1969.

J J Moore
Assistant Secretary

FIDELITY AND DEPOSIT COMPANY OF MARYLAND

FINANCIAL STATEMENT AS OF DECEMBER 31, 1967

ASSETS		LIABILITIES, SURPLUS AND OTHER FUNDS	
*Bonds	$26,096,135.40	Reserve for Unearned Premiums	$29,441,232.62
Stocks	80,176,460.72	Reserve for Claims and Claim Expenses	9,136,529.00
Real Estate	3,669,389.28	Reserve for Taxes and Expenses	1,844,450.00
Cash in Banks and Offices	5,857,252.05	Miscellaneous Reserves and Other Liabilities	564,256.93
Premiums in Course of Collection (less than 90 days old)	5,623,882.30	TOTAL LIABILITIES	40,959,468.55
Reinsurance and Other Accounts Receivable	1,396,664.38	**Capital Stock, Paid Up — $5,000,000.00	
		Surplus — 76,830,315.58	
		Surplus as Regards Policyholders	81,830,315.58
TOTAL ADMITTED ASSETS	$122,819,784.13	TOTAL	$122,819,784.13

Securities carried at $953,519.95 in the above statement are deposited as required by law.

*Securities carried on the basis prescribed by the National Association of Insurance Commissioners. On the basis of December 31, 1967 market quotations for all bonds and stocks owned, this Company's total admitted assets would be $119,333,777.13 and surplus as regards policyholders $78,344,308.58.

**Includes 132,616 shares purchased in 1967 and held as treasury stock.

I, HARRY Y. WRIGHT, Treasurer of the FIDELITY AND DEPOSIT COMPANY OF MARYLAND, do hereby certify that the foregoing statement is a correct exhibit of the assets and liabilities of the said Company, on the 31st day of December, 1967, according to the best of my information, knowledge and belief.

Harry Y. Wright
Treasurer

STATE OF MARYLAND
CITY OF BALTIMORE } ss:

Subscribed and sworn to, before me, a Notary Public of the State of Maryland in the City of Baltimore, this 26th day of January, 1968.

Elenor K. Mitchell
Notary Public

(Partnership Litigation — Group B) *
Exhibit B-2 — Letter (McKinney). Attempt to Expel and Dismiss Fahey (6/3/69).

CASTLE REST
NURSING HOME

116 EAST CASTLE STREET • SYRACUSE NEW YORK 13205 • PHONE (315) 475-1641

June 3, 1969

Mr. Thomas Fahey
Castle Rest Nursing Home
116 Castle Rest Street
Syracuse, New York 13205

Dear Mr. Fahey,

As you know, Article 5.2 of our Partnership Agreement, dated November 6, 1965, provides that without the prior written consent of the Senior Partner, myself, no partner may increase or withdraw all or any part of his capital contribution, and Article 12 provides for the sale of a partnership interest in the event a partner wishes to terminate his interest in the Partnership. These provisions have been in our Partnership Agreement since the original Partnership Agreement was entered into on January 4, 1965. Once previously, about August 1965, without notifying me you sought to sell four percent of your then indicated interest in the Partnership to Doctor George Simpson. A chance remark about November 7, 1965, revealed this fact to me and both your and Doctor Simpson's attention was called to the provisions of Articles 5.2 and 12, and you canceled the transaction. At the time you gave me your assurance that no more of this conduct would ensue.

On Tuesday, April 1, 1969, you informed me that Doctor Simpson's interest in the Partnership "had been sold to you for a substantial amount of cash", and subsequently that af[illegible]n, and again by letter dated May 12, 1969, Dr. Simpson verified that he had conveyed to you "all of (his) interest in the Castle Rest Nursing Home Partnership for a mutually agreed upon amount, which was paid to (him) in cash". Both you and he have refused to give me any further details as to the nature of the transaction or furnish me with copies of the documents in connection with the transaction. On April 2, 1969, I wrote Doctor Simpson and gave him notice that it was in the best interests of the Partnership for him to withdraw under the procedure set forth in the Partnership Agreement under Article 12 thereof, and sent you a copy of said notice. You have continued to fail to notify me concerning the circumstances of the purported transaction, and instead have asserted that because of your supposed acquisition of Doctor Simpson's interests in the Partnership that you and I are now "in equal positions" and that you can "freeze any payments of the funds of the Partnership to any persons". Please be advised that the purchase provisions of Article 12 are applicable to the interest of Doctor Simpson if in fact you have secured some sort of legal or equitable interest therein, and that my letter of April 2, 1969, a copy of which was sent to you, is controlling in connection with its purchase.

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I am sure that you recall my numerous written and oral requests to submit weekly reports, if only a page, to me concerning the administration of the Partnership, and the exercise of your duties as Administrator. This you have refused to do.

Your omission to keep me informed has resulted in things being done by you which should not have been done. For example, without consulting me, you entered into an agreement with Jefferson - Franklin Corporation, apparently for the services of Nick Courtessis in the public relations area, at $ 150.00 per day, for every working day during the year, or a yearly total of approximately $ 40,000.00. I had met Mr. Courtessis only once for a brief period in connection with publicity for the opening of the nursing home, and would certainly have wished to get much better acquainted before a commitment of this magnitude - twice your own salary! You brushed aside my protests at this commitment when I discovered it, and have failed to arrange a meeting with Mr. Courtessis in spite of my requests. Then you renewed the contract again for a further yearly period without consulting me. I have been informed that Jefferson - Franklin Corporation is not a substantial company and that Mr. Courtessis has had limited experience in the public relations field.

I was also deeply disturbed at your abrupt dismissal of Dora Walpole, Director of Nursing, while her son was dying of muscular dystrophy. I do not question the considerable and perhaps greater competence of the new Director of Nursing, Betty Bercier, and the necessity for retaining her, but the callous manner in which this replacement was made, which even required her to change her residence after her son's death, must have been resented by members of the staff as well as by me.

In January 1969 you transferred one 1968 Ford station wagon to your own name from the name of the Partnership without making payment therefor as I required. Instead, without permission, you sought to make payment for the car by reducing your salary by approximately $ 250.00 per month over a period of one year. When I protested this use of partnership funds for your personal financing you stated that this was what you chose to do. Payment for the balance of the purchase price for said automobile is hereby demanded or its immediate reregistration in the name of, and delivery to the Partnership.

On April 2, 1969, I wrote you that I regarded it in the best interests of the Partnership for both of us to be signators on all checks. On April 8, 1969, you wrote me refusing to carry out my instructions as Senior Partner. I replied to your letter in my letter of April 10, 1969, asking you to come to New York on April 22, 1969, and to meet with Mr. Murray and me, bringing your counsel if you so desired, so that we could make one last attempt to work out our differences. You failed to reply to this letter,

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and I called you on April 21, 1969, in the afternoon, and you informed me that you would not come to New York and meet with me, but would see me in Syracuse on May 6, 1969. On May 6, 1969, at our meeting in Syracuse you again refused for me to be a joint signator on all checks and stated that it required a partnership resolution to which you would not agree. You also stated that you authorized the payment of my salary and were considering the cancellation of such salary. You also at this meeting, as you have in the past, disputed my authority to hire partnership counsel and refused to pay such legal bills.

In summary, over the past several years you have entered into secret negotiations on two occasions in direct contravention of the Partnership Agreement in an attempt to either dispose of or acquire partnership interests without prior written consent of me as Senior Partner; you have refused to submit weekly reports as Administrator as requested repeatedly by me; you have refused to answer correspondence; you have made major changes in our executive staff without consulting me; you have refused to answer to disposition of partnership funds; you have refused to come to New York to meet with me; you have conducted your office as Administrator with considerable secrecy letting me know the details thereof as infrequently as possible.

As you know, Article 11.1 of our Agreement provides that any person who shall violate any of the provisions under these Articles in any respect or shall be guilty of such conduct as tends to affect adversely the carrying on of the business of the Partnership, or shall otherwise so conduct himself in matters relative to the Partnership business that it is not reasonably practical to carry on the business of the Partnership with him shall cease to be a partner upon receipt of written notice of the termination of his partnership signed by the Senior Partner, which notice shall state the cause of such termination and shall be served on such partner either personally or by registered mail at his home address.

This letter shall constitute such notice to you of your expulsion from the Partnership, and is hereby served upon you personally.

You are hereby held dismissed as Administrator, and shall turn over your duties immediately to Mr. Francis J. McCarthy. Your salary as Administrator will be paid to you for the full month of June 1969.

As you recall, you are a co-signator on the balance of a loan from the Marine Midland Trust Company of Central New York with a remaining balance of approximately $ 95,000.00. Naturally, I have advised this bank and the other participating banks in the first mortgage loan, of the change in Administrators. I shall promptly arrange for your release from any contingent liability on Partnership indebtedness.

(Partnership Litigation — Group B) *
Exhibit B-2 — Letter (McKinney), Attempt to Expel and Dismiss Fahey (6/3/69).

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I regret very much that our business relationship has to terminate in this way, but it is evident for the reasons stated above that it is not reasonably practical to carry on the business of the Partnership with you. For the sake of our numerous patients, I hope that I may count on you to affect this transition in as orderly a manner as possible.

Very truly yours,

Walker McKinney

WALKER McKINNEY
Senior Partner

WMK:IW

(Partnership Litigation — Group B) •
Exhibit B-3 — Decision (Aronson), Refer Dispute to Arbitration; Deny Restraining Order (6/20/69).

STATE OF NEW YORK
SUPREME COURT

3-3/1

COUNTY OF ONONDAGA

CASTLE REST NURSING HOME and MALCOLM MCKINNEY,

Plaintiffs

Exh B-3

-vs-

THOMAS FAHEY,

Defendant

APPEARANCES:

Hancock, Ryan, Shove & Rust
One Mony Plaza
Syracuse, New York 13202,
Donald J. Kemple, Esq., of counsel,

Attorneys for Plaintiffs

Mackenzie, Smith, Lewis, Michell & Hughes
Onondaga County Savings Bank Building
Syracuse, New York 13202,
John F. Lawton, Esq., of counsel

Attorneys for Defendant

DECISION 6/20/69

ARONSON, J.:

In an action brought by a member of a partnership for a judgment declaring that the interest of the defendant, one of four other partners, has terminated, and also that the defendant account for all his acts and proceedings with regard to the partnership transactions and further for all of the moneys received and paid by the defendant in relation thereto, and of the property thereof, the plaintiff seeks an order directing that the plaintiff continue to have exclusive management of the Castle Rest Nursing Home which is owned and operated by the partnership, and that the defendant, who is the Administrator thereof, be restrained from interfering in any way with the operation thereof. This motion was brought

DECISION - P&S

on by an order to show cause which granted the plaintiff a restraining order against the defendant. The defendant opposes the continuation of the restraining order and has cross-moved for arbitration pursuant to the terms of the partnership agreement.

In his affidavits in support of the application, plaintiff states that the Castle Rest Nursing Home is a partnership formed pursuant to certain Articles of Partnership dated November 16, 1965, as amended; that the partnership consists of the plaintiff, as a senior partner, and three junior partners, one of whom is the defendant, who, after a return of a portion of the capital account of the plaintiff, is entitled to 90% of the profits of the partnership. The plaintiff further states that the Articles of Partnership vest him as senior partner with the right to make all decisions with regard to all actions taken by the partnership, and to all questions of policy, judgment, management and discretion or any other questions relating to the business of the partnership.

The plaintiff in his affidavit charges that the defendant has violated certain provisions of the partnership, to-wit: that he increased his interest in the partnership without the consent of the plaintiff, a senior partner; that he maintained that he was in a position of equality with the plaintiff and that he could withhold payments of funds of the partnership from the plaintiff; that the defendant failed and refused to carry out the decision of the plaintiff that all checks be signed by both plaintiff and defendant, and that he failed to furnish plaintiff with weekly reports; that he refused to consult with plaintiff with regard to expenditures

of partnership funds and on the conduct of partnership affairs, and further that he has dissipated the funds of the partnership by hiring over the objection of the plaintiff a consulting firm at a yearly fee of $30,000, which exceeds the defendant's salary; that he has been insubordinate and has assumed control over the business of the partnership in excess of the authority vested in him, and, as a result of such conduct, pursuant to the provisions of the Articles of Partnership, the defendant's interest therein has ceased, and he has been so notified as provided in the Articles of Partnership. The plaintiff contends that since an impasse has been erected by the conduct of the defendant, it is impossible to carry on the business of the nursing home with the defendant in charge.

4. The defendant, in his affidavit in opposition to the application of the plaintiff to continue the temporary injunction, and in support of his motion to stay the action pending submission of the dispute to arbitration, states that he has been engaged in the hospital and nursing home management field since 1956, after receiving his Masters Degree in Hospital Administration from Columbia University, School of Public Health and Administrative Medicine; that in 1964 he personally conceived the idea of transforming the Syracuse General Hospital, which was about to abandon its facilities, into a modern nursing home; that he consulted with an architect and building contractor to determine the feasibility of the plan; presented it to the state and local agencies and received their approval; that in an effort to secure financial backing he contacted one Theodore Metzger, an attorney, who in turn referred him to the plaintiff and one Dr. George Simpson, both of whom agreed to

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put up the necessary equity capital to purchase the hospital property; that on November 16, 1965 the defendant, the plaintiff, Metzger and Dr. Simpson entered into a partnership agreement whereby plaintiff was to put up 85% of the capital and Dr. Simpson 15%, for which they were to receive a 42.5% and 7.5% interest, respectively, in the profits and in recognition of defendant's services, he was to receive a 45% share of the profits and Metzger was to receive 5% thereof; that under the terms of the agreement the defendant was to receive an annual salary of $20,000, for services as administrator of the hospital, and, implied in the agreement, was that he would continue to so act for a period of ten years. The defendant further states that if the preliminary injunction is granted, he will be deprived of his livelihood and would in all likelihood be forced into bankruptcy. He does not deny that he acquired Dr. Simpson's interest in the partnership and claims that he had a right to do so, particularly after the plaintiff's efforts in that direction failed.

The defendant strenuously opposes the continuation of the restraining order and asks that the same be vacated pending the determination of the litigation on several grounds, one of which is that he has a proprietary interest in the partnership, and another of which is that there is no allegation that he has mis-managed the nursing home or that he is wrongfully depleting or wasting the assets of the partnership. He objects on the further ground that he has in no way denied the plaintiff any of his rights as a senior partner, and further, that the hiring of the consultant on a month-to-month basis is justified in that the firm has and is performing

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valuable services to the partnership as evidenced by the fact that as a result of the consultant's efforts the nursing home during the last two years has received two daily room rate increases which have increased the revenue of the partnership by $150,000.

Significantly, the plaintiff's complaint clearly shows that this is not a case where the plaintiff seeks to dissolve or terminate the partnership. What he seeks to do here is to expel the defendant, who is one of the partners, from the partnership pursuant to one of the provisions of the Articles of Partnership. The prayer for relief makes no request for a final accounting as to each partner's interest in the partnership nor does it ask that a final distribution be made.

The court has examined the balance sheets and combined statement of operations for 1967 and 1968 and finds that the partnership had a net income in 1968 of $10,221.35.

Under all the circumstances, and absent clear and convincing proof that the partnership assets are being depleted or misappropriated by the defendant or that the defendant is guilty of some neglect, wrongdoing, misfeasance, or mismanagement of the partnership assets, it would be inequitable and an abuse of discretion to continue the temporary injunction order heretofore granted which excludes the defendant from participating in the partnership affairs and denies him access to the books and records of the partnership. To do so would in effect predetermine the very issues that have been raised by the charges and counter-charges contained in the affidavits submitted by the respective parties, especially since it appears that the defendant has not only a

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substantial proprietary interest in the partnership but a contract of employment as well. It is elementary that an injunction in advance of trial should not issue unless a clear right is shown both factually and legally (Premier Laundry v. Klein, 273 App. Div. 946).

Turning now to the defendant's application for an order submitting the controversy to arbitration, it is clear that the issues involved herein, namely, does the defendant have a proprietary interest in the partnership, and has there been a breach of the Articles of Partnership by him, fall within the ambit of Article 15 of the Articles of Partnership which provides:

> "15.1 Any claim or controversy arising out of or in any way relating to these Articles or the breach or application thereof shall be settled by arbitration in accordance with the rules of the American Arbitration Association then in effect. Any arbitration award or determination made pursuant to this Section shall be final and binding upon all parties hereto and their legal representatives, and judgment thereon may be entered in any court having jurisdiction thereof."

By this provision the parties to the agreement intended that the resolution of the issues present herein is specifically entrusted to arbitration, not the courts, and the arbitrators are empowered to determine them (Simon v. Vogel, 9 A.D.2d 63; 191 N.Y.S.2d 248). Arbitration provides a speedy and efficient method by which to resolve this controversy.

For the foregoing reasons, the plaintiffs' application to continue the restraining order is denied and the defendant's cross-motion to vacate the restraining order contained in the order to show cause dated June 2, 1969 is granted and the undertaking furnished by the plaintiff therewith should

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be cancelled. The defendant's motion for an order directing the parties hereto to proceed to arbitration in accordance with the rules of the American Arbitration Association, as provided in Article 15 of the Articles of Partnership dated November 16, 1965, is granted, both without costs.

Submit order accordingly.

RICHARD ARONSON
J.S.C.

Dated: June 20, 1969.

(Partnership Litigation — Group B) *
Exhibit B-4 — Letter (McKinney), Attempt to Buy Out Fahey (6/21/69).

CASTLE REST
NURSING HOME

Exh B-4

116 EAST CASTLE STREET • SYRACUSE NEW YORK 13205 • PHONE (315) 475-1641

June 21, 1969

Mr. Thomas M. Fahey
415 Stratford Street
Syracuse, New York

Dear Mr. Fahey:

Article 12 of the Articles of Partnership of Castle Rest Nursing Home provides that in the event that the undersigned, as Senior Partner, decides that it is in the best interest of the Partnership for you as Junior Partner to withdraw, then upon my determination in writing, on 90 days notice, you as Junior Partner are required to withdraw from the Partnership and sell your interest for the amount as determined in Article 12 of the Partnership Agreement.

Please take notice that I have determined and decided that it is in the best interest of the Partnership for you to withdraw from the Partnership.

In the event then, that it should be determined by arbitration or by judicial decision, that you have not been expelled from the Partnership under Article 11 of the Partnership Agreement, this letter constitutes my determination in writing that it is in the best interest of and for the good of the Partnership that you withdraw therefrom and constitutes notice to you that you are required to sell your interest to the Partnership for the amount determined by Article 12 of the Partnership Agreement.

Yours very truly,

Walker McKinney

Walker McKinney
Senior Partner

Ex h B-5

At a Special Term of the Supreme Court held in and for the County of Onondaga at the Court House in the City of Syracuse, New York, on the 10th day of June, 1969.

PRESENT: HON. RICHARD ARONSON,
Justice Presiding.

STATE OF NEW YORK
SUPREME COURT COUNTY OF ONONDAGA

CASTLE REST NURSING HOME and WALKER McKINNEY,

Plaintiffs,

-vs-

THOMAS FAHEY,

Defendant.

DRAFT ONLY 6/23/69

ORDER

Index No. 69-31[illegible]

DRAFT ONLY

The plaintiffs, Castle Rest Nursing Home and Walker McKinney, having moved this Court pursuant to the Order of Show Cause dated June 2, 1969, why an order should not be made herein directing that plaintiff, Walker McKinney, continue and have exclusive management of the business now carried on by the partnership, plaintiff, Castle Rest Nursing Home, and further directing that plaintiff, Walker McKinney, have exclusive possession of all property, goods and assets of the partnership of Castle Rest Nursing Home, together with the books, records, and papers of said firm, and restraining defendant, Thomas Fahey, from interfering in any way with the operation and management of the business of said partnership or from interfering in any way with the assets, employees, or good will of said partnership, and for such other and further relief as may be equitable, and said motion having come on to be heard at a Special Term of the Supreme Court, held in and for the County of Onondaga, at the Court House in the City of Syracuse, New York on the 10th day of June, 1969, and the defendant pursuant to an order to show cause dated June 9th, 1969, having cross-moved for an order pursuant to Section 7502(a) of the Civil Practice Law & Rules, directing

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A

that the controversies which have arisen between the parties herein proceed to arbitration in accordance with the rules of the American Arbitration Association as provided for in Article 15 of the Partnership Agreement, and for an order staying all proceedings in this action pending a determination of said issues by arbitration as aforesaid, and said cross-motion having come on before this Court at the time and place above-mentioned;

NOW, upon reading the affidavit of Walker McKinney verified on the 29th day of May, 1969, and upon the affidavits of Thomas Fahey verified the 9th day of June, 1969, and upon all the pleadings and proceedings had heretofore herein, and after hearing Hancock, Ryan, Shove & Hust, Donald Kemple, Esq., Of Counsel, in support of plaintiffs' motion and in opposition to defendant's cross-motion, and after hearing Mackenzie, Smith, Lewis, Michell & Hughes, John F. Lawton, Esq., Of Counsel, attorneys for defendant, in opposition to plaintiffs' motion and in support of defendants' cross-motion and after due deliberation having been had thereon, it is,

ORDERED, that the temporary injunction contained in the Order to Show Cause of this Court dated June 2nd, 1969, be and the same hereby is vacated and set aside, and it is further,

ORDERED, that plaintiffs' motion for continuance of said temporary injunction be and the same hereby is denied in all respects upon the terms and conditions herein ordered, and it is further,

ORDERED, that defendant's cross-motion for a stay of all further proceedings in this action pending a determination by arbitration in accordance with the rules of the American Arbitration Association as provided for under Article 15 of the Partnership Agreement be and the same hereby is granted, and it is further,

ORDERED, that arbitration be had on all matters that are in dispute as between the plaintiff, Walker McKinney and defendant, Thomas Fahey, arising out of their partnership agree-

(Partnership Litigation — Group B)*
Exhibit B-5 — Order Draft (Lawton for Aronson) (6/23/69).

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ment in accordance with the rules of the American Arbitration Association as provided for under Article 15 of the Partnership Agreement, and it is further,

ORDERED, that in the event either of the parties to this proceeding shall fail to name and designate an arbitrator, as provided for pursuant to the rules of the American Arbitration Association, an application may be made to this Court for the designation and appointment of such arbitrator or arbitrators as provided in Section 7504 of the Civil Practice Law & Rules, and it is further,

ORDERED, that the defendant, Thomas Fahey, be reinstated as a junior partner and Administrator of the plaintiff, Castle Rest Nursing Home, with full powers as those previously possessed by him as said junior partner and Administrator, with exclusive right to administer the plaintiff, Castle Rest Nursing Home, and it is further,

ORDERED, that the plaintiff, Walker McKinney, be given full access to the premises of the plaintiff, Castle Rest Nursing Home, and the right to inspect all books and records of account of plaintiff, Castle Rest Nursing Home, and it is further,

ORDERED, that as a condition to the granting of this order and in lieu of the requirement that the defendant post a $75,000 undertaking, the defendant, Thomas Fahey, is required to submit all checks disbursing monies of the plaintiff, Castle Rest Nursing Home, to the plaintiff, Walker McKinney, for his co-signature, and that a copy of this order be served upon the Marine Midland Trust Company of Central New York, as authority of said bank to change its records to require the co-signature of the plaintiff, Walker McKinney, and the defendant, Thomas Fahey, on all checks drawn against the account of the plaintiff, Castle Rest Nursing Home, and it is further,

ORDERED, that in the event of a dispute arising as between the plaintiff, Walker McKinney, and the defendant,

Thomas Fahey, as to the propriety of any disbursement, then either of said parties may upon three (3) days written notice to the other party or its attorneys, may apply to this Court for a final determination

E N T E R:

Signed this ____ day of June, 1969, in the City of Syracuse, New York.

_____

J.S.C.

(Partnership Litigation — Group B) *
Exhibit B-6 — Order (Aronson), Refer Dispute to Arbitration — Ground Rules for Interim Operations (6/23/69).

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Ex. B-6

At a Special Term of Supreme Court held in and for the County of Onondaga at the County Court House in the City of Syracuse on the 10th day of June, 1969.

PRESENT: HON. RICHARD ARONSON
JUSTICE OF SUPREME COURT

STATE OF NEW YORK
SUPREME COURT
COUNTY OF ONONDAGA

6/23/69

CASTLE REST NURSING HOME and WALKER McKINNEY,

Plaintiffs,

-against-

THOMAS FAHEY,

Defendant.

ORDER

Index No. 69-3154

Plaintiffs Castle Rest Nursing Home and Walker McKinney having moved for an order directing that plaintiff Walker McKinney continue and have exclusive management of the business now carried on by the partnership plaintiff Castle Rest Nursing Home, and further directing that plaintiff Walker McKinney have exclusive possession of all property, goods and assets of the partnership of Castle Rest Nursing Home, together with the books, records and papers of said firm, and restraining defendant Thomas Fahey from interfering in any way with the property and management of the business of said partnership, or interfering in any way with the assets, employees and good will of said partnership, and for such other and further relief as may be equitable, and defendant Thomas Fahey, pursuant to an order to show cause dated June 9th, 1969, having cross-moved for an order pursuant to Section 7503 (a) of the Civil Practice Law and Rules, directing that the controversies which have arisen between the parties herein proceed to arbitration in accordance with the rules of the American Arbitration Association as provided for in Article 15 of the Partnership Agreement, and for an order staying all

ORDER

proceedings in this action pending a determination of said issues by arbitration as aforesaid, and said cross-motion having come on before this Court at the time and place above mentioned;

Now, on reading and filing the order to show cause executed by this Court on June 2, 1969; the affidavit of Walker McKinney sworn to the 29th day of May, 1969; the summons and complaint in this action, the undertaking executed by Fidelity and Deposit Company of Maryland, the affidavits of Thomas M. Fahey dated June 9,1969, the affidavit of plaintiff Walker Mc Kinney, sworn to June 11, 1969, the affidavit of defendant Thomas M. Fahey dated June 13, 1969, and upon all papers, memorandum, and exhibits submitted by the parties and after hearing Hancock, Ryan, Shove & Hust, (Donald J. Kemple, Esq., of counsel), attorneys for plaintiffs, in support of plaintiffs' motion and in opposition to defendant's cross motion, and after hearing Mackenzie, Smith, Lewis, Michell & Hughes, (John F. Lawton, Esq., of Counsel), attorneys for defendant, in opposition to plaintiffs' motion and in support of defendant's cross motion, and due deliberation having been had and the Court having rendered its decision in writing, it is

ORDERED, that the temporary injunction contained in the Order to Show Cause of this Court dated June 2nd, 1969, be and the same hereby is vacated and set aside, and it is further,

ORDERED, that plaintiffs' motion for continuance of said temporary injunction be and the same hereby is denied in all respects and the undertaking given by plaintiff cancelled upon the terms and conditions herein ordered, and it is further,

ORDERED, that defendant's cross motion for a stay of all further proceedings in this action pending a determination by arbitration in accordance with the rules of the American Arbitration Association as provided for under Article 15 of the

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Partnership Agreement be and the same hereby is granted, and it is further,

ORDERED, that arbitration be had on all matters that are in dispute as between the plaintiff Walker McKinney and defendant Thomas Fahey, arising out of their partnership agreement in accordance with the rules of the American Arbitration Association as provided for under Article 15 of the Partnership Agreement, and it is further,

ORDERED, that in the event either of the parties to this proceeding shall fail to name and designate an arbitrator, as provided for pursuant to the rules of the American Arbitration Association, an application may be made to this Court for the designation and appointment of such arbitrator or arbitrators as provided in Section 7504 of the Civil Practice Law & Rules, and it is further,

ORDERED, that the defendant Thomas Fahey be reinstated as a junior partner with powers previously possessed by him as said junior partner, but that for the harmonious operation of the plaintiff Castle Rest Nursing Home, that the duties as administrator of the defendant Thomas Fahey be stayed, without prejudice, pending determination by arbitration of his rights and duties as such, and it is further,

ORDERED, that the plaintiff Walker McKinney in his exercise of his powers as senior partner, to determine all actions required or permitted to be taken by the partnership, with respect to policy, judgment, management, discretion, or otherwise relating to the business of the partnership, shall continue to consult with the defendant Thomas Fahey, and it is further

ORDERED, that upon the consent of plaintiff Walker McKinney, the salary of the defendant Thomas Fahey is continued pending completion of arbitration, and it is further,

ORDERED, that in the event of a dispute arising between the plaintiff Walker McKinney and the defendant Thomas Fahey as to the defendant's right of consultation, then either of

said parties may upon seven (7) days written notice to the other party or his attorneys, may apply to this Court for a final determination, all of the foregoing without costs to any party.

Executed at Syracuse, New York this 23rd day of June, 1969.

WBM
DK
JFL

/S/ Richard Aronson
Justice of Supreme Court

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Sythe B-7

AMERICAN ARBITRATION ASSOCIATION, Administrator

Commercial Arbitration Tribunal

In the Matter of the Arbitration between

Thomas M. Fahey
-and-
Walker McKinney & Castle Rest Nursing Home
AND
Walker McKinney & Castle Rest Nursing Home
-and-
George Simpson

Case Number: 15 10 0032 69

Award of Arbitrator(s)

~~I~~ (WE) THE UNDERSIGNED ARBITRATOR(S), having been designated in accordance with the Arbitration Agreement entered into by the above-named Parties, and dated November 16, 1965 and having been duly sworn and having duly heard the proofs and allegations of the Parties, AWARD, as follows:

THOMAS M. FAHEY, hereinafter referred to as FAHEY, and GEORGE A. SIMPSON, hereinafter referred to as SIMPSON, Partnership interests are terminated as well as FAHEY's position as Administrator.

WALKER McKINNEY AND CASTLE REST NURSING HOME, hereinafter referred to as CASTLE REST, shall pay to FAHEY the sum of ONE HUNDRED SEVENTY THOUSAND DOLLARS ($170,000.00) as compensation for his and SIMPSON'S Partnership interest.

The administrative fees and expenses of the American Arbitration Association in the total amount of $813.55 shall be borne by CASTLE REST. Therefore, CASTLE REST shall pay to FAHEY the sum of $225.00 for that portion of the fees previously advanced by FAHEY to the association, and CASTLE REST shall pay to SIMPSON the sum of $25.00 for that portion of the fees previously advanced by SIMPSON to the Association, and CASTLE REST shall pay to the American Arbitration association the sum of $338.55 for the balance of the fees and expenses still due the Association.

The fees for the remuneration of the Arbitrators in the amount of $10,875.00 shall be borne equally by the Parties. Therefore, FAHEY shall pay to the American Arbitration association the sum of $3,125.00 for the balance of his share of the arbitrators' fees still due the Association, and CASTLE REST shall pay to the American Arbitration Association the sum of $1,125.00 for the balance of their share of the arbitrators' fees still due the Association, and SIMPSON shall pay to the American Arbitration Association the sum of $3,625.00 for his share of the arbitrators' fees still due the Association.

Sidney A. Devorsetz

Bruce O. Jacobs

Francis E. Maloney, Jr.

DATED:

STATE OF NEW YORK
COUNTY OF ONONDAGA } ss.:

On this 4th day of September, 19 70, before me personally came and appeared SIDNEY A. DEVORSETZ to me known and known to me to be the individual(s) described in and who executed the foregoing instrument and he acknowledged to me that he executed the same.

In the Matter of the Arbitration between

Thomas M. Fahey
-and-
Walker McKinney & Castle Rest Nursing Home
AND
Walker McKinney & Castle Rest Nursing Home
-and-
George Simpson

15 10 0032 69

Award of Arbitrators
additional jurats

STATE OF NEW YORK
ss.:
COUNTY OF ONONDAGA

On this 9th day of September, 1970, before me personally came and appeared BRUCE O. JACOBS to me known and known to me to be the individual described in and who executed the foregoing instrument and he acknowledged to me that he executed the same.

Patrick J. Cunningham

PATRICK J. CUNNINGHAM
Notary Public in the State of New York
Qualified in Onon. Co. No. 34-5533850
My Commission Expires March 30, 1972

STATE OF NEW YORK
ss.:
COUNTY OF ONONDAGA

On this 4th day of September, 1970, before me personally came and appeared FRANCIS E. MALONEY, JR., to me known and known to me to be the individual described in and who executed the foregoing instrument and he acknowledged to me that he executed the same.

Dallas Sumner

DALLAS SUMNER
Notary Public in the State of New York
Qualified in Onon. Co. No. 34-5533875
My Commission Expires March 30, 1972

(Partnership Litigation — Group B) •
Exhibit B-7 — Arbitration Award (9/8/70).

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AMERICAN ARBITRATION ASSOCIATION
140 WEST 51st STREET • NEW YORK, NEW YORK 10020
CABLE ADDRESS: ARBITRATION

RE: 15 10 0032 69

September 9, 1970

Thomas H. Fahey
-and-
Walker McKinney & Castle Rest Nursing H
AND
Walker McKinney & Castle Rest Nursing H
-and-
George Simpson

Neal P. McCurn, Esq.
600 CBS Bank Building
Syracuse, New York 13202

Donald M. Kemple, Esq.
1 Hony Plaza
Syracuse, New York 13202

Harry A. LeBien, Esq.
1 Wall Street
New York, New York 10005

Gentlemen:

Pursuant to the Commercial Arbitration Rules and by direction of the Arbitrators, I hereby transmit to you their duly signed and executed Award.

Very truly yours,

Robert E. Meade
Regional Director
REM:l
Enc.

CC: Sidney Devorsetz, Esq.
Bruce O. Jacobs, Esq.
Francis E. Maloney, Jr., Esq.
William E. Murray, Esq.

(Partnership Litigation — Group B) *
Exhibit B-8 — Motion (Fahey) To Confirm Arbitration Award (10/1/70).

Copy to Ps' attys (Murray) "
Copy to Co-D's atty (LeBien); Copy to Fahey " B-8

STATE OF NEW YORK
SUPREME COURT COUNTY OF ONONDAGA

CASTLE REST NURSING HOME and
WALTER McKINLEY,

Plaintiffs,

-vs-

THOMAS FAHEY and
GEORGE SIMPSON, M.D.,

Defendants.

Exh B-8

10/1/70

NOTICE OF MOTION FOR CONFIRMATION OF AWARD

Index No._____

S I R S:

PLEASE TAKE NOTICE, that upon the unanimous award of the arbitrators in the above-entitled proceeding, dated and acknowledged the 4th and 8th days of September, 1970, and duly delivered to defendants herein on the 10th day of September, 1970, the agreement for arbitration dated November 16th, 1965, and upon the annexed affidavit of John F. Lawton, Esq., sworn to the 1st day of October, 1970, and upon all the papers and proceedings had heretofor herein, defendant Thomas Fahey, will move this court at a Special Term of this Court to be held on the 13th day of October, 1970, at the Oswego County Court House in the City of Oswego, New York, at 10:00 o'clock in the forenoon of that day or as soon thereafter as counsel can be heard, for an order:

1) confirming the unanimous award of the arbitrators pursuant to Section 7510 of the CPLR upon the ground that said award was delivered to plaintiffs herein less than one year prior to this motion and has not been vacated or modified under CPLR 7511;
2) directing judgment be entered thereon pursuant to Section 7514 of the CPLR; and
3) for such other and further relief as to this Court may seem just and proper under the premises, together with the costs of this motion.

Dated: October1st,1970.

MACKENZIE,SMITH,LEWIS,MICHELL & HUGHES
Attorneys for Defendant, Fahey
600 Onondaga Savings Bank Building
Syracuse, New York 13202

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TO: Donald J. Kemple, Esq.
HANCOCK, ESTABROOK, RYAN, SHOVE & HUST
Attorneys for Plaintiffs
One Mony Plaza
Syracuse, New York 13202

William E. Murray, Esq.
GOLDSTEIN, GURFEIN, SHAMES & HYDE
Attorneys for Plaintiffs
655 Madison Avenue
New York, New York 10021

Harry A. BeBien, Esq.
GIFFORD, WOODY, CARTER & HAYS
Attorneys for Defendant, Simpson
One Wall Street
New York, New York 10005

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STATE OF NEW YORK
SUPREME COURT — COUNTY OF ONONDAGA

(Same Title) — AFFIDAVIT

STATE OF NEW YORK)
COUNTY OF ONONDAGA) SS:
CITY OF SYRACUSE)

10/1/70

JOHN F. LAWTON, being duly sworn, deposes and says:

1) That he is an attorney at law and partner in the firm of Mackenzie, Smith, Lewis, Michell & Hughes, attorneys for the defendant, Thomas M. Fahey, and as such is familiar with the facts surrounding this matter.

2) That on or about June 2nd, 1969, plaintiff herein obtained an order to show cause from The Hon. Richard Aronson, Justice of Supreme Court, enjoining defendant, Thomas M. Fahey, from interfering in any way with the operation, management and property of the partnership of plaintiff, Castle Rest Nursing Home, and that plaintiff Walker McKinney was given exclusive management of the business pending a hearing and determination of plaintiffs' application for an order pursuant to Partnership Law Section 75. Thereafter, defendant Thomas Fahey, appeared in opposition to said motion and simultaneously obtained an order to show cause from this court dated June 9th, 1969, requiring the plaintiffs herein to show cause why an order should not be granted pursuant to Section 7503(a) of the CPLR requiring that the controversies between the parties be determined by arbitration in accordance with the rules of the American Arbitration Association.

3) That by order dated June 10th, 1969, Hon. Richard Aronson, Justice of this Court, denied plaintiffs' motion for a temporary injunction, permanently stayed all further proceedings, and ordered that arbitration be had on all matters in dispute between plaintiff Walker McKinney and defendant Thomas Fahey in accordance with the rules of the American Arbitration Association as provided for in Article 15 of the Partnership Agreement.

(Partnership Litigation — Group B) •
Exhibit B-8 — Motion (Fahey) To Confirm Arbitration Award
(10/1/70).

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4) That thereafter, plaintiffs Walker McKinney and Castle Rest Nursing Home, commenced an action in Supreme Court, County of Onondaga, against defendants Thomas Fahey, George Simpson, M.D. and one Theodore Metzger, wherein the plaintiffs sought to recover the sum of $130,000 with interest thereon and for a judgment requiring the defendants named therein to transfer the partnership interest then owned by defendant George Simpson, M.D. to Castle Rest Nursing Home. Pursuant to an order to show cause dated July 3, 1969, an order was granted by Hon. Richard Aronson, Justice of this Court, dated July 21, 1969, permanently staying said action and ordering that arbitration be had on all matters in dispute between the plaintiffs and the defendant Thomas Fahey.

5) That on or about July 1, 1969, plaintiffs Walker McKinney and Castle Rest Nursing Home commenced an action against Thomas Fahey, Nicholas A. Courtessis, and Jefferson-Franklin Corporation, wherein the plaintiff sought to recover $60,000 damages.

6) That thereafter, pursuant to a Notice of Motion dated July 1, 1969, an order was granted by Hon. Richard Aronson, Justice of this Court, dated July 11th, 1969, permanently staying said action and ordering that arbitration be had on all matters in dispute between the plaintiffs and defendant Thomas Fahey.

7) That thereafter, with the consent of the parties herein, the following were named as arbitrators to hear and determine the above matters:

Sidney Devorsetz, Esq.
Hills Building
Syracuse, New York 13202

Bruce O. Jacobs, Esq.
University Building
Syracuse, New York 13202

Francis E. Maloney, Jr.
State Tower Building
Syracuse, New York 13202

8) That thereafter, on or about the 22nd day of October, 1969, at a time and place appointed, notice of which was given to

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the parties herein, the said three arbitrators hereinbefore named having previously subscribed to their oath of office proceeded to hear the proofs of the parties.

9) That said hearing was adjourned from time to time for the purpose of taking further testimony.

10) That all of said hearings were attended by the parties or their respective counsel and by the aforesaid arbitrators.

11) That the final hearing of said arbitration was held before said arbitrators on the 14th day of March, 1970, at which time all parties stated to the arbitrators that they had no further testimony to offer and the hearing was closed.

12) That thereafter and on the 8th day of September 19, 1970, after the said arbitrators had completed and studied all of the facts, circumstances, elements and proofs entering into the controversies so submitted to them as aforesaid, and after they had considered all the evidence and arguments submitted between the parties to said arbitration agreement, the arbitrators were unanimous in coming to a decision and made an award in writing duly acknowledged and dated on the 4th and 8th days of September, 1970.

13) That annexed hereto and marked "Exhibit A" is a true copy of said award. A copy of said award was duly delivered to said deponent on the 10th day of September, 1970.

WHEREFORE, your deponent respectfully prays that an order be made herein confirming said award and directing that judgment be entered thereon in the Supreme Court of the State of New York, County of Onondaga, and that the defendants be allowed the costs of this motion to confirm and that said defendants have such other and further relief as to the court may seem just and proper.

s/ John F. Lawton
John F. Lawton

Subscribed & Sworn to before me this 1st day of October, 1970:

[illegible]
CLAIRE [illegible]
Deputy Clerk of Deeds
City of Syracuse N. Y.
My Commission Expires [illegible] 19[illegible]

(Partnership Litigation — Group B) *
Exhibit B-8 — Motion (Fahey) To Confirm Arbitration Award
(10/1/70).

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STATE OF NEW YORK
SUPREME COURT COUNTY OF ONONDAGA

CASTLE REST NURSING HOME and
WALKER MC KINNEY,

Plaintiffs,

-vs-

AFFIDAVIT OF SERVICE BY MAIL

THOMAS FAHEY and GEORGE SIMPSON, M.D.,

Defendants.

STATE OF NEW YORK)
COUNTY OF ONONDAGA) SS:
CITY OF SYRACUSE)

CLAIRE GRIFFEN , being duly sworn, deposes and says that she served the within notice of motion ~~to preclude~~ Donald J. Kemple, Esq., William E. Murray, Esq., and on Harry A. LeBien, Esq. ~~and Esq~~ , the and co-defendant respectively, attorneys for the plaintiffs/ in the within entitled action , on the 1st day of October , 1970 through the Post Office, by depositing a true and correct copy of the same properly enclosed in a postpaid wrapper, in a Post Office Box, regularly maintained by the Government of the United States at Onondaga County Savings Bank Building and under the care of the General Post Office, in the City of Syracuse, New York, that being then the post office of the attorneys for the defendant Fahey/ , directed to the said attorneys above-mentioned at One MONY Plaza, Syracuse, N.Y.; 655 Madison Ave., NewYork, NY; and One Wall Street, New York, N.Y. respectively, , that being the address designated by them for that purpose upon the preceding papers in this action.

That deponent is over 21 years of age.

s/ Claire Griffen

Subscribed and sworn to before me
this 1st day of October , 1970:

s/ [illegible]
Notary Public

(Partnership Litigation — Group B) *
Exhibit B-9 — Cross-Motion (McKinney) To Vacate or Modify Award (10/9/70).

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Exh B-9

STATE OF NEW YORK
SUPREME COURT COUNTY OF ONONDAGA

CASTLE REST NURSING HOME AND WALKER McKINNEY,

Plaintiffs,

-vs-

THOMAS FAHEY AND GEORGE A. SIMPSON, M.D.

Defendants.

NOTICE OF CROSS-MOTION TO VACATE OR MODIFY ARBITRATION AWARD

Index No. 69-3154

10/9/70

PLEASE TAKE NOTICE, that upon the affidavit of Donald J. Kemple, sworn to the 9th day of October, 1970, the award of the arbitrators in the arbitration proceedings between plaintiffs and defendants, the Articles of Partnership dated November 16, 1955, and upon all the papers and proceedings heretofore before this court and the testimony and exhibits before the arbitrators, plaintiffs Walker McKinney and Castle Rest Nursing Home and Jane McKinney will cross-move at a Special Term of Supreme Court, State of New York to be held in and for the County of Oswego at the County Courthouse in the City of Oswego, New York on the 13th day of October, 1970 at ten o'clock in the forenoon of that day or as soon thereafter as counsel can be heard, for a judgment pursuant to CPLR 7511, vacating, setting aside or modifying the award of the arbitrators herein to the extent that said award declares that Walker McKinney and Castle Rest Nursing Home pay to Thomas Fahey, One Hundred Seventy Thousand Dollars ($170,000) as compensation for the partnership interests of Thomas Fahey and George A. Simpson, M. D., striking the aforesaid provision from the award and confirming the award as so corrected and modified upon the grounds that the arbitrators exceeded their powers and have made upon a matter not submitted to them, and granting to plaintiffs such other and different relief as may be just and proper, to-

with the costs of this motion.

Dated at Syracuse, New York this 9th day of October, 1970.

HANCOCK, ESTABROOK, RYAN, SHOVE & HUNT
Attorneys for Plaintiffs
Walker McKinney and Castle Rest
Nursing Home
Office and Post Office Address
One Mony Plaza
Syracuse, New York 13202
Phone (315) 471-3151

GOLDSTEIN, GURFEIN, SHAMES & HYDE
Attorneys for Jane McKinney and
Plaintiffs Walker McKinney and
Castle Rest Nursing Home
Office and Post Office Address
655 Madison Avenue
New York, New York 10021
Phone (212) 838-3700

TO: MACKENZIE, SMITH, LEWIS, MICHELL & HUGHES
Attorneys for Defendant Thomas Fahey
Office and Post Office Address
600 Onondaga County Savings Bank Bldg.
Syracuse, New York 13202

GIFFORD, WOODY, CARTER & HAYS
Attorneys for Defendant George Simpson, M.D.
Office and Post Office Address
One Wall Street
New York, New York 10005

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STATE OF NEW YORK
SUPREME COURT COUNTY OF ONONDAGA

CASTLE REST NURSING HOME AND WALKER McKINNEY,

Plaintiffs,

-vs-

THOMAS FAHEY AND GEORGE SIMPSON, M.D.

Defendants.

AFFIDAVIT

Index No. 69-3154

10/9/70
A.

STATE OF NEW YORK)
COUNTY OF ONONDAGA) SS.:

DONALD J. KEMPLE, being duly sworn, deposes and says:

FIRST: I am an attorney at law duly admitted to practice before the courts of the State of New York and I am a member of the firm of Hancock, Estabrook, Ryan, Shove and Hust, Esqs. who with Goldstein, Gurfein, Shames and Hyde, Esqs. (William E. Murray, Esq.) have been attorneys for Walker McKinney, Jane McKinney and Castle Rest Nursing Home from the inception of this action and throughout the ensuing arbitration proceeding.

SECOND: This affidavit is made in opposition to the motion of defendant Fahey to confirm the award of the arbitrators pursuant to CPLR 7510 and to enter judgment thereon pursuant to CPLR 7514 and this affidavit is further presented in support of the motion of plaintiffs Walker McKinney and Castle Rest Nursing Home and Jane McKinney to vacate or modify so much of the award of the arbitrators herein as provides:

> "Walker McKinney and Castle Rest Nursing Home, hereinafter referred to as Castle Rest, shall pay to Fahey the sum of One Hundred Seventy Thousand Dollars ($170,000) as compensation for his and Simpson's partnership interest."

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THIRD: The motion of plaintiffs Walker McKinney and Castle Rest Nursing Home and Jane M Kinney to vacate or to modify the aforesaid portion of the award and the opposition to the Fahey motion to confirm is brought pursuant to CPLR 7511 (b) (1) (iii) in that the arbitrators have disregarded the contract between the parties, have exceeded their power by making a new contract for the parties and have imposed obligations upon Walker McKinney and Castle Rest Nursing Home beyond those set forth in the agreement containing the arbitration clause and further pursuant to CPLR 7511 (c) (2) in that the arbitrators have made an award in excess of the arbitration agreement provisions which constitutes an award on a matter not submitted to them.

PRIOR PROCEEDINGS IN THIS ACTION
AND IN THE ARBITRATION

FOURTH: When it became necessary to remove Thomas Fahey as administrator of Castle Rest Nursing Home and to expel him as partner, Walker McKinney and Castle Rest Nursing Home took the initial steps in the form of this action in Supreme Court rather than through arbitration not only because an immediate enforceable removal of Fahey was necessary for the smooth operation of the nursing home, but also because Walker McKinney and Jane McKinney, as non-residents of this area were fearful that an impartial arbitration could not be obtained and that the partnership agreement which set forth and protected their rights would be disregarded and rewritten in the arbitration giving Thomas Fahey a windfall to which he was not entitled under said agreement.

FIFTH: It is because that agreement has been disregarded that this motion to vacate or modify has been made and the confirmation of the award opposed.

SIXTH: Thomas Fahey insisted that his rights under the partnership agreement be enforced by demanding arbitration and this court, by order of July 23, 1969, ordered arbitration of disputes between Walker McKinney and Thomas Fahey and further

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stays another action instituted by Walker McKinney and Jane McKinney against Fahey and the other Castle Rest Nursing Home partners, George Simpson, M.D. and Theodore Metzger.

SEVENTH: Walker McKinney and Jane McKinney could not properly oppose the Fahey demand for arbitration or the court orders based on such demands since they were as much bound by the contract provision requiring arbitration, as were Fahey and the arbitrators by the balance of the contract. Thus both McKinneys made a demand for arbitration against George Simpson, M.D. requesting that arbitration proceeding take place in New York City. At that time, Walker McKinney and Jane McKinney also made application to the American Arbitration Association to have the Fahey arbitration moved to New York City, to a neutral environment where complete impartiality could be insured.

EIGHTH: The request of the McKinneys to have the Fahey arbitration removed to New York City was denied and subsequently the Simpson arbitration was joined with the Fahey arbitration. After considerable difficulty in selecting arbitrators, the arbitration itself commenced on October 22, 1969 and the hearing continued on through March 14, 1970 creating a long record and many exhibits. After exchange of voluminous briefs, the award of the arbitrators was delivered on September 10, 1970.

NINTH: The one page award, which is now before this court, contains no discussion or decision on any of the issues submitted to the arbitrators and made absolutely no attempt to pass upon the seventeen pages and ninety requested findings of fact and conclusions of law submitted on behalf of Walker McKinney and Jane McKinney and Castle Rest Nursing Home and does not indicate how the $170,000 figure to be paid to Fahey was computed. If it were not for the integrity and competence of the arbitrators, it could be charged that the device of omitting any background for the award was chosen as a method of avoiding the scrutiny of the court over the exercise of executive power, the disregard of the contract itself and an award not warranted by the contract.

TENTH: There was no dispute between the McKinneys and Fahey as to the two main issues in the arbitration proceeding:

(a) Whether Fahey had been properly expelled from the partnership and removed as administrator for cause pursuant to Article 11 of the partnership agreement;

(b) Whether Fahey's interest as partner should be acquired by the partnership pursuant to the buy-out provisions of Article 12 of the contract.

The arbitrators agreed that Fahey's interest as administrator and partner were terminated. Neither Fahey nor the McKinneys now challenge this holding. Yet this termination was apparently not for cause under Article 11, but pursuant to the Article 12 buy-out provisions although the amount to be paid to Fahey far exceeded the amount set forth in that Article 12.

ELEVENTH: The partnership agreement which Fahey relied upon when he demanded that this court order arbitration (Fahey affidavit of June 9, 1969 - Paragraph "2"), and the partnership agreement upon which Walker McKinney relied as fixing his rights and obligations and which the arbitrators have disregarded or rewritten is the partnership agreement dated November 16, 1965.

THE ARBITRATORS HAVE EXCEEDED THEIR POWERS IN REFUSING TO EXPEL FAHEY FOR CAUSE IGNORING AND REPUDIATING THE EXPRESS PROVISIONS OF THE PARTNERSHIP AGREEMENT

TWELFTH: Article 11 of the partnership agreement provides for expulsion of a partner on notice from McKinney where a partner:

(a) "shall violate any of the provisions of these Articles in any respect", (emphasis added)

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(b) "shall be guilty of any conduct as tends to affect adversely the carrying on of the business of the partnership,"

(c) "shall otherwise so conduct himself in matters relating to the partnership business that it is not reasonably practicable to carry on the business of the partnership with him..."

THIRTEENTH: One of the provisions of the partnership agreement, Article 13, any violation of which is grounds for expulsion, governs management of the partnershipand provides:

ARTICLE 13

MANAGEMENT OF PARTNERSHIP

"Except as otherwise provided by law and except as otherwise provided in these Articles, all actions required or permitted herein to be taken by the partnership, and all questions of policy, judgment, management, discretion or otherwise relating to the business of the partnership shall, after consultation among all the partners, be determined by the Senior Partner."

Article 3.1 specifically designates Walker McKinney as Senior Partner.

FOURTEENTH: Contrary to the right of Walker McKinney to manage and control the partnership, Fahey, during the course of the arbitration admitted, conceded and indeed boldly asserted:

(a) that he always considered himself in full control of the partnership and always asserted that control. (Pages 469 to 475 of hearing transcript);

(b) that he did not yield to the determination of Walker McKinney on questions

of judgment, management or discretion. 81/8

(Transcript - pages 544-545.)

FIFTEENTH: Fahey's concept of himself as in control of the partnership with ultimate management rights is exemplified in his conduct as partner and administrator which was undisputed in the arbitration:

(a) Fahey refused to furnish to Walker McKinney written weekly reports as required by McKinney and went over McKinney's head in deciding that such reports were not necessary; (526) (1726) (1741) (1742) (1918)

(b) Despite McKinney's instructions to the contrary, Fahey defied McKinney and secretly renewed a $39,300 per year retainer agreement with Jefferson-Franklin Corp. (1784-1797) (Exhibit 64); (598)

(c) Fahey refused to yield to McKinney's decision that William E. Murray, Esq. should be partnership attorney;

(d) Fahey then refused to follow McKinney's decision and determination that partnership checks should be signed jointly by McKinney and Fahey, and went so far as to assert the power to withhold partnership funds from McKinney and refused to meet with McKinney to resolve the differences between the partners. (Exhibit CCC) (Exhibit GGG) (1949) (1951) (475) (1960-1965) (Exhibit EEE)

SIXTEENTH: By refusing to declare that Fahey's partnership interest has been terminated for cause under Article 11 for

a violation of Fahey's rights of management and control under Article 13, and by refusing to declare that there should be no compensation for the termination of Fahey's interest, the arbitrators either disregarded the provisions of Article 13 giving McKinney management rights superior to Fahey or disregarded the provisions of Article 11 prescribing Fahey's discharge for violation of that Article "in any respect."

SEVENTEENTH: By ignoring Article 13 and conceding Fahey's claim to control over the partnership or by ignoring Article 11 requiring Fahey's expulsion for usurpation of management rights and insubordination to McKinney, the arbitrators whose power is derived from the partnership agreement containing the arbitration clause have rewritten that agreement to vest decision making powers in matters of policy, judgment, management and discretion in Fahey and to make any violation of the agreement no longer grounds for expulsion of a partner.

EIGHTEENTH: There was no dispute on the arbitration:

(a) that Fahey executed so-called "annual retainer agreements" in the amount of $39,300 per year with Jefferson-Franklin Corp. for "public relations and related communications function" (Exhibit 60)

(b) that Fahey also participated in an arrangement whereby Jefferson-Franklin Corp. was able to assign its accounts receivables with Castle Rest Nursing Home to Lincoln National Bank at a time when Castle Rest did not have sufficient funds to pay those invoices. (Exhibit 65) (594)

(c) that Fahey was in the office of Nicholas Gorton who was "Jefferson-Franklin Corp." almost every day for two years, fifteen to twenty days a

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health for periods as long as four hours per day (703-707) (Exhibit 98), that Fahey attempted to become developer of another nursing home in Syracuse while an employee of and partner in Castle Rest Nursing Home (Exhibit 99), that he acted as consultant for another nursing home and negotiated for other ventures in the Syracuse area all without knowledge of his partners. (779) (Exhibit 99) (787) (110)

(d) that Fahey purchased television sets on behalf of the nursing home more than a year before the sets were needed and appropriated three of these sets to his own use in his home and that Fahey failed to admit this misappropriation prior to the arbitration despite inquiry by the nursing home. (483-489) (Exhibit 49)

(e) that Fahey conducted the negotiations for and attempted purchase of the interest of Dr. Simpson in complete and deliberate secrecy, with all of the partners agreeing to withhold knowledge of the transaction from Walker McKinney until it was completed contrary to the exclusive buy-out provisions of Article 12.

NINETEENTH: Fahey's exorbitant and secret commitment and payment of partnership funds to Jefferson-Franklin Corp., his failure to devote his full time to the business of the partnership, his engagement in outside activities and attempts to promote his own interests at least "tends to affect adversely the carrying on of the business of the partnership."

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TWENTY-FIRST: Fahey's usurpation of management rights vested in McKinney, his refusal to obey directions of McKinney, which created a stalemate and impasse in the management of the partnership, Fahey's unauthorized and forbidden commitment of partnership funds to Jefferson-Franklin Corp. (Counterclaim), his personal appropriation of partnership property, and Fahey's total destruction of any trust and confidence which may have placed in him made it "not reasonably practicable to carry on the business of the partnership with him."

TWENTY-FIRST: The arbitrators nevertheless disregarded or ignored the provisions of Article 11 which provides for expulsion of a partner for conduct "as tends to affect adversely the carrying on of the business of the partnership" or for conduct making it "not reasonably practicable to carry on the business of the partnership with him..."

TWENTY-SECOND: By refusing to expel Fahey for misappropriation and insubordination and by awarding him compensation for his partnership status, the arbitrators have repudiated every contract term in relation to expulsion for cause and the award of compensation should not be permitted to stand.

THE ARBITRATORS HAVE AT LEAST EXCEEDED
THEIR AUTHORITY AND POWER BY AWARDING
FAHEY COMPENSATION FOR HIS INTEREST IN EXCESS
OF THE HIGHEST AMOUNT ALLOWABLE UNDER ARTICLE 12

TWENTY-THIRD: Under the partnership agreement, if Fahey's partnership interest has not been terminated for cause, the only provision under which Castle Rest Nursing Home can be required to pay compensation for Fahey's partnership interest is Article 12 - the buy-out provision.

TWENTY-EIGHTH: To require Castle Rest Nursing Home to pay for Fahey's interest under any formula other than as set forth in Article 12, must require a repudiation of the contract terms of the agreement in relation to the adjustment of the price.

B 7/v

TWENTY-FIFTH: Article 12 provides that when Senior Partner, Walker McKinney, "decides that it is of the best interest of the partnership for a junior partner to withdraw," then ninety days after receipt of notice to that effect Thomas Fahey, as Junior Partner, must sell his interest for an amount set thereafter in that article.

TWENTY-SIXTH: The arbitrators in holding that Castle Rest Nursing Home and Walker McKinney must pay $170,000 to Thomas Fahey for the combined Fahey-Simpson interests, must necessarily have acted under Article 12 since that is the only Article which grants the power and authority for payment for a partnership interest.

TWENTY-SEVENTH: Article 12 contains three amounts which must be combined to determine the compensation to be paid for a partnership interest:

(a) Subdivision C makes a partner's interest, according to the last certified statement and verification of his capital account the basic figure.

(b) To this figure is to be added any increase in such interest including shares in undistributed profits if any and any decrease in such interest is to be deducted. (Subdivision D)

(c) To Fahey's share is to be added the flat sum of $90,000 and to Simpson's share is to be added the flat sum of $15,000. (Subdivision F.2, F.3)

TWENTY-EIGHTH: (a) The basic figure is set forth on the last certified statement of the partnership which was as of December 31, 1965 (Exhibit 34) and that statement at Page 5 thereof shows that Fahey has no capital account and that the capital account of Mr. Simpson is a negative balance of $1,715.52. (Exhibit 34B)

(b) Both Fahey and Simpson verified these accounts and specifically stated that the capital accounts were correct as of December 31, 1968. (Exhibit 133).

(c) In addition, the partnership agreement, if it is not to be ignored, provides in Article 14.3 that "the annual certified statement and verification of each partner's interest in the partnership as provided in Section 14.2 above, (which requires a verification of each partner's interest annually), shall be binding and conclusive on each partner." (emphasis added).

(d) The basic figure of the partnership interest and capital account of Fahey under Article 12 must then be zero.

(e) The basic figure of the partnership interest and capital account of Simpson as of the date of the last certified statement was a minus $1,715.52, but the basic figure of his interest and capital account had risen to a deficiency of $1,310.56 as of June 31, 1969 as determined by the accountants. (Exhibit 36)

TWENTY-NINTH: (a) The profits of the partnership for all of 1969 by Fahey's computations (Exhibit TTTT) was $8,441.18)

(b) Under Article 7 of the partnership agreement, the share of Dr. Simpson in these undistributed profits could never exceed 15% thereof and this portion of 1969 profits would still be insufficient to eliminate the deficient capital position of Dr. Simpson as it stood at the end of 1968.

(c) The adjustments to the partnership interest of Dr. Simpson, after adding his deficient capital amount and his maximum undistributed profits, could not have exceeded zero.

(d) Therefore, pursuant to Article 12 the total compensation to be paid for the Simpson interest cannot exceed the flat sum of $15,000 provided for in Article F.3.

THIRTIETH: (a) Article 7 provides that the capital accounts of McKinney and Simpson entitled these partners to accumulated claims on future profits. As of December 31, 1968, the

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previous capital account had produced for McKinney alone a right to $90,509.97 in future profits after that date which far exceeded any profits for 1969. (Hearing transcript of 3-5-70, page 39).

(b) Any percentage of profits which Fahey might claim under Article 7.4 was reduced to nothing because of additional capital contributions which exceeded $350.00 and through operation of Article 12 (H) which reduced Fahey's share of profits in proportion to capital contributions, (Exhibit 130) (Hearing transcript of 3-5-70, page 10)

(c) Fahey's share in undistributed profits in any event was as set forth above, zero.

(d) With no right to undistributed profits and no capital account, the total compensation for Fahey's interest could not have exceeded the flat sum of $90,000 provided for in Article 12, F.2.

THIRTY-FIRST: The accountants have confirmed that the upper limit of compensation which can be paid for Fahey's interest is $90,000 as set forth in their November 4, 1969 letter wherein they calculated the amount in accordance with Article 12 (C) (D) (E) and (F). (Exhibit 127)

THIRTY-SECOND: Under Article 12 then the maximum total compensation for which Walker McKinney and Castle Rest Nursing Home must pay for the combined Fahey-Simpson interest is $105,000 ($15,000 Simpson - $90,000 Fahey).

THIRTY-THIRD: Since the award amounts to $70,000 or an amount of $65,000 in excess of the $105,000 compensation for both interests required by Article 12, then the computations made by the arbitrators disregard the formula specified in the contract even though such disregard was not apparent on the face of the award itself.

THIRTY-FOURTH: The buy-out limitations of Article 12 cannot be disregarded and exceeded since to do so results in the making of a new contract and the imposition of additional obligations upon Walker McKinney and Castle Rest Nursing Home.

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THIRTY-FIFTH: In the absence of a limitation of a buy-out amount in accordance with the formula supplied by the contract, the arbitrators have acted on a quantum meruit basis or on their idea of the value of what the various interests are worth. Their power and authority, however, is limited to the contract terms and the arbitrators cannot go beyond these limitations and include an element of value specifically excluded by the contract and in effect impose a different standard and different provisions upon Walker McKinney and Jane McKinney or Castle Rest Nursing Home. (Article 12 (G) excluding other elements of value)

THE ARBITRATORS HAVE EXCEEDED THEIR POWERS BY FAILING TO CREDIT PAYMENTS AGAINST THE AWARD LIMITED BY ARTICLE 12

THIRTY-SIXTH: As set forth in the November 4, 1969 letter of the partnership accountants, (Exhibit 127) the notice to withdraw under Article 12 was served on Thomas Fahey on June 21, 1969 (Exhibit 31) and the 90-day period within which Fahey was required to withdraw ended on September 19, 1969.

THIRTY-SEVENTH: During the prior proceedings before this Court, Walker McKinney and Castle Rest Nursing Home agreed to make payments to Fahey during the course of the arbitration (Exhibit 30), with the amount thereof to be deducted from any award made to Fahey.

THIRTY-EIGHTH: This court in his June 23, 1969 order provided that by reason of the aforesaid consent of McKinney, that salary was to continue pending completion of the arbitration.

THIRTY-NINTH: Unless the formula specified in the partnership agreement is to be repudiated, the status of Thomas Fahey as partner and administrator ended on September 19, 1969 and he was entitled to no salary since that date and payments made to him must be credited on any award.

FORTIETH: Between September, 1969 and September, 1970, the date of the termination of the arbitration of proceedings by

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delivery of the award, Thomas Fahey received $20,000 from Castle Rest Nursing Home.

FORTY-FIRST: Since Thomas Fahey has received $20,000 during a one-year period when he had no contractual rights thereto either as partner and administrator this sum of $20,000 should be credited against any award made in favor of Thomas Fahey or it involves a repudiation of the contract terms in relation to the adjustment of price.

FORTY-SECOND: Since the award amounts to $170,000 or exactly twice the amount of $85,000 maximum compensation required by Article 12, (maximum $105,000 less $20,000 previous payments) then the computations made by the arbitrators disregard the formula specified in the contract even though such disregard was not apparent on the face of the award itself.

FORTY-THIRD: Although Article 12 requires that a partnership interest is to be acquired by and sold to the partnership and that only the Castle Rest Nursing Home and not any individual partner is required to purchase the interest of the withdrawing partner, the arbitrators have imposed liability upon Walker McKinney personally, making him as well as the partnership personally liable for payment to Fahey, again contrary to the provisions of the partnership agreement.

Plaintiffs Walker McKinney and Castle Rest Nursing Home therefore respectfully request an order pursuant to CPLR 7511, (b) (1) (iii) and CPLR 7511 (c) (2) vacating or modifying the award of the arbitrators herein to the extent that said award declares that Walker McKinney and Castle Rest Nursing Home pay to Thomas Fahey $170,000 as compensation for the combined Fahey-Simpson partnership interests and for such other and further relief as to the court may seem just and proper together with the costs of this motion.

Donald A. Campbell

Sworn to before me this 9th day of October

3-A
17

415 Stratford Street
Syracuse, New York
September 21, 1966

Mr. Walker McKinney
47 East 87th Street
New York, New York 10028

COPY

Dear Walker:

This is to confirm the fact that I agree to obtain your specific approval before disposing of any interest in the Castle Rest Nursing Home that shall be vested in me.

Very truly yours,

Thomas M. Fahey

TMF:ifw

(Partnership Litigation — Group B) •
Exhibit B-9 — Cross-Motion (McKinney) To Vacate or Modify
Award (10/9/70).

AMERICAN ARBITRATION ASSOCIATION, Administrator

Commercial Arbitration Tribunal

In the Matter of the Arbitration between
Thomas H. Fahey
-and-
Walker McKinney & Castle Rest Nursing Home
AND
Walker McKinney & Castle Rest Nursing Home
-and-
George Simpson
Case Number: 15 10 0032 69

Award of Arbitrator(s)

WE (WE) THE UNDERSIGNED ARBITRATOR(S), having been designated in accordance with the Arbitration Agreement entered into by the above-named Parties, and dated November 16, 1965 and having been duly sworn and having duly heard the proofs and allegations of the Parties, AWARD, as follows:

THOMAS M. FAHEY, hereinafter referred to as FAHEY, and GEORGE A. SIMPSON, hereinafter referred to as SIMPSON, Partnership interests are terminated as well as FAHEY's position as Administrator.

WALKER McKINNEY AND CASTLE REST NURSING HOME, hereinafter referred to as CASTLE REST, shall pay to FAHEY the sum of ONE HUNDRED SEVENTY THOUSAND DOLLARS ($170,000.00) as compensation for his and SIMPSON'S Partnership interest.

The administrative fees and expenses of the American Arbitration Association in the total amount of $313.55 shall be borne by CASTLE REST. Therefore, CASTLE REST shall pay to FAHEY the sum of $225.00 for that portion of the fees previously advanced by FAHEY to the Association, and CASTLE REST shall pay to SIMPSON the sum of $25.00 for that portion of the fees previously advanced by SIMPSON to the Association, and CASTLE REST shall pay to the American Arbitration Association the sum of $338.55 for the balance of the fees and expenses still due the Association.

The fees for the remuneration of the Arbitrators in the amount of $10,875.00 shall be borne equally by the Parties. Therefore, FAHEY shall pay to the American Arbitration Association the sum of $3,125.00 for the balance of his share of the arbitrators' fees still due the Association, and CASTLE REST shall pay to the American Arbitration Association the sum of $1,125.00 for the balance of their share of the arbitrators' fees still due the Association, and SIMPSON shall pay to the American Arbitration Association the sum of $3,625.00 for his share of the arbitrators' fees still due the Association.

Sidney N. Devorsetz

Bruce O. Jacobs

Francis E. Maloney, Jr.

DATED:

STATE OF NEW YORK }
COUNTY OF ONONDAGA } ss.:

On this 4th day of September, 19 70, before me personally came and appeared SIDNEY N. DEVORSETZ to me known and known to me to be the individual(s) described in and who executed the foregoing instrument and he acknowledged to me that he executed the same.

(Partnership Litigation — Group B) *

Exhibit B-9 — Cross-Motion (McKinney) To Vacate or Modify Award (10/9/70).

In the Matter of the Arbitration between

Thomas M. Fahey
-and-
Walker McKinney & Castle Rest Nursing Home
AND
Walker McKinney & Castle Rest Nursing Home
-and-
George Simpson

Award of Arbitrators
additional jurats

15 10 0032 69

STATE OF NEW YORK
ss.:
COUNTY OF ONONDAGA

On this 8th day of September, 1970, before me personally came and appeared BRUCE O. JACOBS to me known and known to me to be the individual described in and who executed the foregoing instrument and he acknowledged to me that he executed the same.

Patrick J. Cunningham

PATRICK J. CUNNINGHAM
Notary Public in the State of New York
Qualified in Onon. Co. No. 34-5533350
My Commission Expires March 30, 1972

STATE OF NEW YORK
ss.:
COUNTY OF ONONDAGA

On this 4th day of September, 1970, before me personally came and appeared FRANCIS E. MALONEY, JR., to me known and known to me to be the individual described in and who executed the foregoing instrument and he acknowledged to me that he executed the same.

Dallas Sumner

DALLAS SUMNER
Notary Public in the State of New York
Qualified in Onon. Co. No. 34-5543275
My Commission Expires March 30, 1972

(Partnership Litigation — Group B) *
Exhibit B-10 — Decision (Aronson) Modifying Award (1/6/71).

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Exh 8-10

STATE OF NEW YORK
SUPREME COURT COUNTY OF ONONDAGA

CASTLE REST NURSING HOME
and WALKER McKINNEY,

Plaintiffs

-vs-

THOMAS FAHEY and
GEORGE SIMPSON, M.D.,

Defendants

APPEARANCES:

1/6/71

Hancock, Estabrook, Ryan, Shove & Hust
One Mony Plaza
Syracuse, New York 13202,
Donald J. Kemple, of counsel,

Attorneys for Plaintiffs

Mackenzie, Smith, Lewis, Michell & Hughes
600 Onondaga Savings Bank Building
Syracuse, New York 13202,
John F. Lawton, of counsel,

Attorneys For Defendant Fahey

DECISION

ARONSON, J.

This is a motion made by the petitioner, Thomas Fahey, pursuant to CPLR 7510, for an order confirming an arbitration award and directing that judgment be entered thereon pursuant to CPLR 7514. Respondents have cross-moved pursuant to CPLR 7511 for an order vacating or modifying the award. Both motions will be considered together. Notwithstanding that the parties have been designated in the papers submitted herein as "plaintiffs" and "defendants", Thomas Fahey and George Simpson are hereinafter referred to as "petitioners" and Castle Rest Nursing Home and Walker McKinney as "respondents".

By way of background, the arbitration upon which the award is based stems from a dispute which arose between the

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respondent, Walker McKinney, the senior partner, and the petitioner, Thomas Fahey, one of the junior partners, both of whom were signatories to a partnership agreement entered into for the purpose of operating the Castle Rest Nursing Home. Although pursuant to the agreement Fahey was to act as administrator of the nursing home, all actions required or permitted to be taken by the partnership and all questions of policy, judgment, management and discretion or otherwise relating to the business of the partnership was, after consultation among all partners, to be determined by the senior partner.

On June 21, 1969, McKinney advised Fahey by letter that he had determined that it was for the best interests of the partnership that Fahey withdraw therefrom and sell his interest for an amount to be determined pursuant to Article 12 of the Partnership Agreement. Upon Fahey's refusal to comply with this request, McKinney brought an action for a declaratory judgment, alleging that Fahey, as a junior partner, had violated the provisions of the Partnership Agreement, and sought a declaration that Fahey had ceased to be a partner of the Castle Rest Nursing Home and that his partnership interest therein was terminated. He also asked that Fahey be enjoined from interfering with the operation and management of the nursing home.

Simultaneously, McKinney moved by order to show cause for an order granting him exclusive management of the business, and also for a preliminary injunction restraining Fahey from interfering in any way with the operation of the business until the determination of the action. Fahey opposed the

application and moved that all issues raised in the action be submitted to arbitration pursuant to Article 15 of the Partnership Agreement. An order was granted which gave McKinney control of the management of the nursing home and directed that Fahey be paid his salary until the arbitration was completed.

Thereafter both respondents and Fahey made application to the American Arbitration Association for a hearing and after extended hearings before three arbitrators which covered a period from October 22, 1969 to March 14, 1970, resulting in approximately 2500 pages of testimony, the arbitrators rendered their decision on September 8, 1970, in which they found that Thomas M. Fahey's and George A. Simpson's partnership interests, as well as Fahey's position as administrator, were terminated, and further that Walker McKinney and Castle Rest Nursing Home pay to Fahey the sum of $170,000, as compensation for his and Simpson's partnership interests. In that connection, it is undisputed that at the time the action was commenced Fahey had acquired Simpson's interest as a junior partner.

The respondents concur with and have no quarrel as to that portion of the arbitrators' award which terminates the interests of Fahey and Simpson. However, it is with that portion of the award that directs them to pay the petitioner Fahey the sum of $170,000 for his and Simpson's partnership interests that they disagree. The thrust of the respondents' argument is that the arbitrators had no authority under the Partnership Agreement to award Fahey any compensation whatsoever for his interest in the partnership; that when they awarded him $170,000 as compensation for his interest therein,

they completely ignored the terms of the agreement which is the source of their power to act and, therefore, that portion of the award should be either vacated or modified. The respondents further contend that, in any event, even if Fahey is entitled to be paid for his interest in the partnership, according to the provisions of the agreement only the Partnership, not Walker McKinney, is obligated to make such payment.

Obviously, the award of the arbitrators fails to recite the reasons for it. However, in that regard, the award is not invalid for that reason alone (Matter of Willow Fabrics, Inc. [Carolina Freight Carriers Corp.], 20 A.D.2d 864, affirmed 16 N.Y.2d 929).

> "There is no authority which sanctions an inquisition of arbitrators for the purpose of determining the processes by which they arrived at an award."
>
> Matter of Shirley Silk Co., Inc. v. American Silk Mills, Inc., 275 App. Div. 575, 577.

Moreover, the court cannot vacate an award except upon the very limited grounds specified by the statute (CPLR 7511).

It has long been the rule which was laid down by the Court of Appeals in Matter of Wilkins, 169 N.Y. 494, 496, that

> "Where the merits of a controversy are referred to an arbitrator selected by the parties, his determination, either as to the law or the facts, is final and conclusive, and a court will not open an award unless perverse misconstruction or positive misconduct upon the part of the arbitrator is plainly established, or there is some provision in the agreement of submission authorizing it. The award of an arbitrator cannot be set aside for mere errors of judgment, either as to the law or as to the facts. If he keeps within his jurisdiction and is not guilty of fraud, corruption or other misconduct affecting his award, it is unassailable, operates as a final and conclusive judgment, and however disappointing it may be the parties must abide by it."

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However, the respondents urge that this is not a situation where the arbitrators merely committed errors of law and fact, but rather exceeded their jurisdiction and authority or power. They contend that, in order to arrive at the figure of $170,000 which the arbitrators awarded to Fahey, they completely ignored and disregarded the provisions of Article 12 of the contract between the parties. If the respondents are to prevail on their motion, the court must be satisfied that the arbitrators actually did exceed their power (CPLR 7511[b]).

Fahey contends that the Board of Arbitrators could have based their computation of the value of his partnership interest upon a dissolution of the partnership rather than under the provisions of Article 12 of the partnership agreement. He further argues that the court must presume that even if the award was made under Article 12, the arbitrators had a valid basis therefor.

Having determined, for whatever reason, that the interest of Fahey in the partnership and as administrator of the Castle Rest Nursing Home had terminated, the arbitrators then proceeded to award Fahey compensation for his interest in the partnership. At that point they were duty bound to implement the provisions of the contract referable thereto and were limited to the provisions of Article 12 of the agreement which clearly and specifically delineates the formula for evaluating the partnership interest of a junior partner upon his voluntary or involuntary withdrawal. Neither the court nor the arbitrators can ignore the clear provisions of the contract in that regard (Matter of Stange v. Thompson-Starrett Co., 261 N.Y.37), and it must be presumed that, no other reason appearing there-

for, the termination of Fahey's interest in the partnership was effected under the provisions of Article 12 of the agreement. This determination is further evidenced by McKinney's letter of June 21, 1969 to Fahey whereby McKinney attempted to terminate Fahey's interest, wherein McKinney cited Article 12 of the agreement as the basis for the termination. If the arbitrators ignored the formula provided in Article 12 for evaluating a junior partner's interest and based the award to Fahey upon grounds extrinsic to the contract, the award cannot stand since it involves a repudiation and re-writing of the contract in relation to value and, therefore, in making the award of $170,000, the arbitrators exceeded their jurisdiction and authority (Matter of Stange v. Thompson-Starrett Co., supra).

Article 12 sets forth three criteria to be considered in computing the amount to be paid a junior partner in the event that he is required to withdraw from the partnership. The basic figure is the partner's interest in the partnership according to the last certified statement and verification of his account, or the last signed quarterly statement, whichever shall be later. That basic figure is to be adjusted by all increases or decreases in the partner's interest subsequent to the date of the statement and also by the partner's share of undistributed profits or losses or other debits properly made to his account. Once the value of both Fahey's and Simpson's partnership interests have been determined, Fahey is entitled to the sum of $90,000 in addition thereto and George Simpson would be entitled to the sum of $15,000 in addition thereto.

The court is constrained to vacate the arbitrators' award of $170,000 to Thomas Fahey on the ground that it appears

that the arbitrators did in fact act in excess of the powers and jurisdiction granted to them under the subject contract. As the court held in Matter of Granite Worsted Mills (Cowen), 25 N.Y.2d 451, at page 456:

> ".... where it is clear from the face of the award itself or from an examination of the computations made by the arbitrator that the arbitrator has included an element of d mages specifically excluded by the contract pursuant to which he obtained his very authority to act, he exceeds his powers under the contract and the award thus made must be vacated upon proper application."

When it is obvious and indisputable that the arbitrators computed their award in total disregard of the specific formula provided in the contract under which they received their authority to act, and that their award was based on grounds outside the scope of the contract, their award must be vacated. Such an award manifests more than those errors of law and fact which must be disregarded by the court in which this proceeding is brought; rather it evidences an overstepping of their jurisdiction by the arbitrators (Matter of Stange v. Thompson-Starrett Co., supra).

It cannot be disputed that Fahey's withdrawal became effective ninety days after the letter of dismissal of June 21, 1969. The last certified statement of the accountants for the partnership is that covering the period ending December 31, 1968, and this, according to the terms of Article 12(C), is the statement from which the basic figures must be computed. That statement shows that Fahey had no capital account or partner's interest in the partnership and that Simpson's interest was actually a deficit in the amount of $1,715.52. Therefore, there can be no positive basic

figure for either Simpson or Fahey.

The situation with respect to undistributed profits is not as clear cut as that regarding the basic figure. Nonetheless, based upon the statement and figures as to the amount of undistributed profits submitted by the petitioner Fahey at the arbitration hearing, at best the most profit to which he would be entitled for the year 1969 would be $49,016.92. Moreover, in that connection it must be noted that that figure was referable to the entire year of 1969, so that part of it might be attributable to that portion of the year following the termination of Fahey's partnership interest. Concededly, Fahey claimed that he also had a capital account of $6,020.02 for the period ending December 31, 1969, but this figure cannot be considered because the contract specifically states that the amount of a partner's capital account shall be determined according to the last certified statement of the partnership which, in this instance, was dated December 31,1968, and was verified by Fahey as being correct. Accordingly, even if the arbitrators accepted Fahey's computations as to the amount of the undistributed profits, the total of his and Simpson's interests combined could not even remotely a[illegible] the amount awarded to Fahey.

Pursuant to the order of this court [illegible] to be paid his salary until the arbitration was [illegible] to date he has received a total of $20,000 from [illegible]tnership subsequent to his relinquishing his administrat[illegible]hip of the nursing home. Because he has rendered no services to the partnership since that time, the $20,000, or whatever he has been paid to date, must be considered as an offset to whatever

amount it is eventually determined he is entitled to be paid by the partnership for his and Dr. Simpson's interests there

The objection of the respondent to that portion of t arbitrators' award which requires that both Walker McKinney and the Castle Rest Nursing Home pay Fahey the amount awarded to him as compensation is well taken since the contract speci fically provides that any amount due a junior partner pursuan to Article 12(A) or (B) shall be paid by the partnership and not by any of the remaining members thereof and, therefore, any award to be made herein should be modified to reflect tha provision of the contract.

Since it clearly appears that the arbitrators have exceeded their powers in making the award to Thomas M. Fahey in the amount of $170,000 as compensation for his and Dr. Simpson's partnership interest, the award is hereby vacated and set aside pursuant to CPLR 7511(b)(iii). Pursuant to CPLR 7511(d), the question of the amount of compensation to be awarded to the petitioner Fahey is remitted to new arbitrators to be appointed in accordance with Article 75 of the Civil Practice Law and Rules for rehearing and determination. The award of the arbitrators in all other respects is confirmed.

Submit order on notice.

S/

RICHARD ARONSON
J.S.C.

Dated: January 6, 1971.

(Partnership Litigation — Group B) *

Exhibit B-11 — Letter (Kemple), Order Draft (6/7/71).

HANCOCK, ESTABROOK, RYAN, SHOVE & HUST
COUNSELORS AT LAW
ONE HONY PLAZA
SYRACUSE, NEW YORK 13202
TELEPHONE (315) 471-3151

Exh B-11

June 7, 1971

Hon. Richard Aronson
Justice of Supreme Court
Supreme Court Chambers
Syracuse, New York

Re: Castle Rest Nursing Home vs. Fahey

Dear Justice Aronson:

Enclosed please find originals of two proposed orders in the above matter. The one order is submitted as being in accordance with the decision in the above matter. It is my understanding Mr. Scaccia will require several days to review this matter and that the order will be settled before you upon Mr. Scaccia's review thereof.

The other order is the order directing the County Clerk to file a certificate of partnership as we discussed in your office. It is necessary that this certificate be filed and it was agreed that the order requiring this filing be drawn separately from the order in the above action. It is my understanding from our meeting that this would be executed in the immediate future.

Accordingly, I would request that if no objections to the order requiring filing of the certificate are made prior to June 10, the order if satisfactory to you be signed and returned to me in the enclosed envelope. Copies of the orders and of this letter are being forwarded to Mr. Scaccia and Mr. Lawton.

Very truly yours,

HANCOCK, ESTABROOK, RYAN, SHOVE & HUST

By: Donald J. Kemple

Donald J. Kemple

DJK:dja
Encs.

(Partnership Litigation — Group B) *
Exhibit B-12 — Order (Aronson) Modifying Award (2/16/72). B-12/1

At a Special Term of the Supreme Court of the State of New York held in and for the County of Oswego at the Courthouse in the City of Oswego on the 13th day of October, 1970

PRESENT: HONORABLE RICHARD ARONSON
Justice of Supreme Court

Exh B-12

STATE OF NEW YORK
SUPREME COURT COUNTY OF ONONDAGA

2/16/72

CASTLE REST NURSING HOME and WALKER MC KINNEY,

Plaintiffs,

vs.

THOMAS FAHEY and GEORGE SIMPSON, M.D.,

Defendants

Order

Index No. 69-3154

Defendant Thomas Fahey having moved for judgment pursuant to Section 7510 of the Civil Practice Law and Rules confirming the award of the arbitrators dated September 8, 1970 and plaintiffs Castle Rest Nursing Home and Walker McKinney having cross-moved for judgment pursuant to CPLR 7511 vacating, setting aside or modifying the award of the arbitrators herein to the extent that said award declares that Walker McKinney and Castle Rest Nursing Home pay to Thomas Fahey One Hundred Seventy Thousand Dollars ($170,000.00) as compensation for the partnership interests of Thomas Fahey and George A. Simpson, M.D. striking the aforesaid provision from the award and confirming the award as so corrected and modified, and said motions having duly come on to be heard before this Court on the 13th day of October, 1970,

NOW on reading and filing the notice of motion dated October 1, 1970, for confirmation of the award, the affidavit of John F. Lawton, Esq. sworn to the 1st day of October, 1970 in support of said motion together with the award of the arbitrators dated and acknowledged on September 8, 1970, the notice of cross motion of plaintiffs Castle Rest Nursing Home

and Walker McKinney to vacate or modify said arbitration award, the affidavit of Donald J. Kemple, Esq. sworn to the 9th day of October 1970, the articles of partnership dated November 16, 1965, all of the papers and proceedings before the court and the testimony and exhibits before the arbitrators, and the answering affidavit of John F. Lawton, Esq. sworn to the 22nd day of October, 1970,

AND after hearing Mackenzie, Smith, Lewis, Michell, & Hughes, (John F. Lawton, Esq. of counsel) attorneys for defendant Thomas Fahey in support of the motion of defendant Fahey to confirm the award and in opposition to motion of plaintiffs to vacate or modify the award, and after hearing Hancock, Estabrook, Ryan, Shove & Hust, and Goldstein, Gurfein, Shames & Hyde attorneys for Castle Rest Nursing Home and Walker McKinney, (Donald J. Kemple, Esq. of counsel), in opposition to the motion of defendant Fahey to confirm the award and in support of the cross-motion of plaintiffs to vacate or modify the award, and due deliberation having been had and the court having rendered its decision in writing dated January 6, 1971, it is,

ORDERED that the motion of defendant Thomas Fahey to confirm the award of the arbitrators dated September 8, 1970 be and the same hereby is denied, and it is further,

ORDERED that the cross-motion of plaintiffs Castle Rest Nursing Home and Walker McKinney to vacate, set aside or modify the award of the arbitrators herein to the extent that said award declares that Walker McKinney and Castle Rest Nursing Home pay to Thomas Fahey, One Hundred Seventy Thousand Dollars ($170,000.00) as compensation for the partnership interest of Thomas Fahey and George A. Simpson, M.D., striking the aforesaid provision from the award and confirming the award as so corrected and modified, be and the same is granted, and it

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is further,

ORDERED that the portion of the award of the arbitrators dated the 8th day of September, 1970 which provides;

> "WALKER MC KINNEY AND CASTLE REST NURSING HOME, Hereinafter referred to as Castle Rest, shall pay to Fahey the sum of One Hundred Seventy Thousand Dollars ($170,000.00) as compensation for his and Simpson's Partnership interest"

be and the same hereby is stricken from said award and the award vacated to that extent, and it is further,

ORDERED that the award of the arbitrators dated September 8, 1970, a true copy of which is annexed hereto be and hereby is in all other respects confirmed, and it is further,

ORDERED that a rehearing and determination of the question of the amount of compensation to be awarded to defendant Fahey be and the same hereby is remitted to new arbitrators to be appointed in accordance with the provision of Article 75 of the Civil Practice Law and Rules, and it is further,

ORDERED that there be deducted from any award which may be made to Defendant Fahey by arbitrators, all amounts paid to defendant Fahey by plaintiffs Castle Rest Nursing Home and Walker McKinney subsequent to September 19th, 1969.

Dated at Syracuse, New York this 16th day of February, 1972.

s/ Richard Aronson

Richard Aronson
Justice of Supreme Court

B-13/1

Ex. B-13

STATE OF NEW YORK
SUPREME COURT COUNTY OF ONONDAGA

CASTLE REST NURSING HOME and WALKER McKINNEY,

Plaintiffs,

v.

THOMAS FAHEY and GEORGE A. SIMPSON, M.D.,

Defendants.

NOTICE OF APPEAL

INDEX NO. 69-3154

3/ /72

PLEASE TAKE NOTICE, that the above named defendant Thomas Fahey hereby appeals to the Appellate Division of the Supreme Court, Fourth Judicial Department, from the Order of the Supreme Court, Onondaga County, in the above entitled action, filed and entered in the Office of the Clerk of the County of Onondaga on the 16th day of February, 1972, which Order stated as follows:

"ORDERED that the motion of defendant Thomas Fahey to confirm the award of the arbitrators dated September 8, 1970 be and the same hereby is denied, and it is further,

ORDERED that the cross-motion of plaintiffs Castle Rest Nursing Home and Walker McKinney to vacate, set aside or modify the award of the arbitrators herein to the extent that said award declares that Walker McKinney and Castle Rest Nursing Home pay to Thomas Fahey, One Hundred Seventy Thousand Dollars ($170,000.00) as compensation for the partnership interests of Thomas Fahey and George A. Simpson, M.D., striking the aforesaid provision from the award and confirming the award as so corrected and modified, be and the same is granted, and it is further,

ORDERED that the portion of the award of the arbitrators dated the 8th day of September, 1970 which provides;

WALKER MC KINNEY AND CASTLE REST NURSING HOME, hereinafter referred to as Castle Rest, shall pay to Fahey the sum of One Hundred Seventy Thousand Dollars ($170,000.00) as compensation for his and Simpson's partnership interest

be and the same hereby is stricken from said award and the award vacated to that extent, and it is further,

ORDERED, that the award of the arbitrators dated September 8, 1970, a true copy of which is annexed hereto be and hereby is in all other respects confirmed, and it is further,

ORDERED that a rehearing and determination of the question of the amount of compensation to be awarded to defendant Fahey be and the same hereby is remitted to new arbitrators to be appointed in accordance with the provision of Article 75 of the Civil Practice Law and Rules, and it is further,

ORDERED that there be deducted from any award which may be made to Defendant Fahey by arbitrators, all amounts paid to defendant Fahey by plaintiffs Castle Rest Nursing Home and Walker McKinney subsequent to September 19th, 1969."

and defendant-appellant appeals from each and every part of the Order, insofar as it finds for plaintiff and against defendant.

DATED: March ___, 1972

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Ex 4 B-14

3/20/72

STATE OF NEW YORK
SUPREME COURT COUNTY OF ONONDAGA

CASTLE REST NURSING HOME and WALKER McKINNEY,

Plaintiffs,

vs.

THOMAS FAHEY and GEORGE SIMPSON, M.D.,

Defendants

CROSS NOTICE OF APPEAL

Index No. 69-3154

PLEASE TAKE NOTICE that the above named plaintiffs Castle Rest Nursing Home and Walker McKinney hereby appeal to the Appellate Division of the Supreme Court of the State of New York, Fourth Judicial Department from so much of an order of Supreme Court, Onondaga County (Honorable Richard Aronson) dated February 16, 1972 and entered in the office of the Clerk of the County of Onondaga on that date, as orders a rehearing and determination of the question of the amount of compensation to be awarded to defendant Fahey and remits said question to arbitrators to be appointed in accordance with the provision of Article 75 of the Civil Practice Law and Rules, and from such part only and plaintiffs do not cross-appeal from any other portion of said order except as herein specifically set forth.

Dated at Syracuse, New York this 20th day of March, 1972.

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Clerk of County Court
Onondaga County Courthouse
Syracuse, New York 13202

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AMERICAN ARBITRATION ASSOCIATION

COMMERCIAL ARBITRATION

In the Matter

of

The Arbitration Between

THOMAS FAHEY and

WALKER McKINNEY and CASTLE REST NURSING HOME

and

GEORGE SIMPSON

SUPPLEMENTAL MEMORANDUM IN OPPOSITION TO RESPONDENTS' MOTION TO DISMISS

MACKENZIE, SMITH, LEWIS,
MICHELL & HUGHES
Attorneys for Plaintiff
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(Partnership Litigation — Group B)*

Exhibit B-15 — Brief on *Millet* v. *Slocum*, 4 AD 2d 528, Aff'd 5 NY 2d 734 (1957), covering the law on expulsion of a partner.

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SUPPLEMENTAL MEMORANDUM IN OPPOSITION TO RESPONDENTS' MOTION TO DISMISS

Respondents' motion to dismiss the complaint as a matter of law can be summarized by the following excerpts from his memorandum:

> "... this arbitration boils down to this: Since McKinney has the right to manage and control the partnership, Fahey, as the usurper and challenger to those rights, had to be expelled from the partnership.
>
> "He is no longer a partner and the arbitrators must so hold as a matter of law ..."
>
> - Page 11, Respondents' Memo

> "Even if there were no wrongdoings on Fahey's part, the very existence of this arbitration and the present state of hostility between the partners requires that the discretionary "buyout" provision of Article 12 be recognized."
>
> - Page 14, Respondents' Memo

Partners cannot, as a matter of law, either expel a co-partner or compel him to resign or withdraw, on the ground that it is in the best interest of the partnership. Millet v. Slocum, 4 AD 2d 528, Aff'd 5 NY 2d 734 (1957).

This case clearly holds that partners cannot arbitrarily expel one another, regardless of the language of a partnership agreement that gives them the apparent power of decision to do so. Whether or not a partner should be expelled or compelled

(Partnership Litigation — Group B) *
Exhibit B-15 — Brief on *Millet* v. *Slocum*, 4 AD 2d 528, Aff'd 5 NY 2d 734 (1957), covering the law on expulsion of a partner.

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to withdraw is a question of fact, not a question of law, and must be decided by a trial court.

Therefore, since respondent has raised a question of law which is held in Millet v. Slocum, supra to be a question of fact, the motion to dismiss should be denied.

In seeking to justify, as a matter of law, the removal of a partner "for the best interest of the partnership," respondent seeks to create a distinction between the removal of a partner by "expulsion" and removal of a partner by a forced "withdrawal" or "buyout".

The same attempt at this kind of distinction was held to be a spurious one in Millet v. Slocum, supra. In that case, the partners voted, in accordance with the partnership agreement, to request a partner to resign "for the good of the partnership," and he did resign. Nine days later, they voted not to accept the resignation, and to expel him instead. The court clearly held that the first request for a resignation itself was equivalent to an expulsion. The court said:

> "We regard the action of the defendants at the meeting of June 7th at which time the plaintiff was asked to present his resignation as the equivalent of an expulsion."

The court, after weighing the facts, found the expulsion was wrongful, and therefore, constituted a breach

of the partnership agreement. The court considered this kind of breach to be so wrongful that it refused to grant the partnership the equitable relief of enforcing, by injunction, a valid restrictive covenant that was also contained in the partnership agreement that would have prevented the expelled partner (a physician) from practicing medicine in the same vicinity after his termination from the partnership. The court said:

> "We conclude that the demand at the meeting of June 7th for plaintiff's resignation from the partnership and the subsequent expulsion at the meeting on June 16th constituted such a breach of the partnership agreement as not to entitle the defendants to the equitable relief of injuction to enforce the restrictive covenant."

The court therefore prohibits expulsion and involuntary withdrawal as a matter of law, and considers a factual finding of wrongful expulsion to be a severe breach of the partnership contract.

Respondent readily admits in his Memorandum that Millet v. Slocum, supra, prohibits "expulsion" as a matter of law -- and then carefully omits any reference to the court's holding that involuntary withdrawal is equivalent to expulsion.

Instead, respondent simply makes an unsupported statement that the involuntary "buyout" provision (Article 12) of the Castle Rest partnership agreement is enforceable -- and then refers to a completely irrelevant case, where the court

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did not even consider the question of whether an involuntary withdrawal is enforceable as a matter of law, rather than triable as an issue of fact. Gill v. Mallory, 274 AD 84, 1st Dept. (1948). In this case, the expelled plaintiffs were seeking not a trial of the propriety of the expulsion, but a temporary injunction to (1) enjoin expulsion and (2) compel dissolution of the firm. The court held there was no basis for dissolving the firm, and no grounds for the equitable relief of a temporary injuction, and specifically, did not pass on any questions involving the partnership agreement. The court said:

> "In deciding that plaintiffs are not entitled to a temporary injunction, we, of course, do not pass upon any of the other issues which may arise out of the partnership agreement or the transactions of the parties thereunder."

It was not until nine years after Gill v. Mallory, supra, that the specific issue involved in this memorandum was raised and settled in Millet v. Slocum, supra.

Respondent's additional contention that the involuntary "buyout" should be enforced on the factual grounds that this arbitration itself is in process, and because there is hostility between the parties obviously has no basis in law. This is really a preposterous argument to put forth since the partnership agreement itself calls for compulsory arbitration of all

Exhibit B-15 — Brief on *Millet* v. *Slocum*, 4 AD 2d 528, Aff'd 5 NY 2d 734 (1957), covering the law on expulsion of a partner.

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disputes, and the stated presence of hostility is at most a frivolous basis for dismissing a complaint.

Furthermore, this case is not limited to the narrow question of law raised by respondent. It includes all the disputes existing between Thomas Fahey and Walker McKinney.

We submit that all the facts in this case will show that, as a matter of law and equity, Walker McKinney's rights are limited to those of any minority partner owning only 42.5% of the partnership.

We submit that Article 13, even by ~~this~~ its own language, is completely self-limiting, and when taken together with its own origin, and with the complete evolution of all the partnership agreements, and with the transfers of partnership interests, -- these facts individually and all together constitute a complete refutation of the position taken by Walker McKinney.

We submit that all the facts in this case will show that the management and control of the partnership has existed in the majority partner, Thomas Fahey, in fact and in practice for 5½ years -- until the minority partner, Walker McKinney, breached the partnership agreement by circumventing the compulsory arbitration provision and wrongfully obtaining a temporary injunction (later set aside) to which he was not entitled.

(In this connection, we would like to call the attention of the arbitrators at this time to Article 10 of the

(Partnership Litigation — Group B) •

Exhibit B-15 — Brief on *Miller v. Slocum*, 4 AD 2d 528, Aff'd 5 NY 2d 734 (1957), covering the law on expulsion of a partner.

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General Partnership Agreement, which provides for automatic expulsion of any partner who brings proceedings to wind up the partnership.)

Our position in this case depends not only on the facts we are presenting through our own witnesses, but also on the facts to be revealed from the cross-examination of all of respondent's witnesses.

For the foregoing reasons, we respectfully submit that there is no basis in law to justify the granting of respondent's motion to dismiss the complaint, and it should therefore be denied.

Dated: February 10, 1970.

MACKENZIE, SMITH, LEWIS, MICHELL & HUGHES
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600 O.S.B. Building
Syracuse, New York 13202

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4 A.D.2d 528 Cite as: 167 NYS2d 136

J. Bradford MILLET, Plaintiff-Respondent-Appellant, v. Millard M. SLOCUM, Charles S. Dickson, William B. Dickson, Willard H. Willis, Charles C. Shepard, Frank J. Slater, James E. Compson, Robert D. Hubbard, John F. Rudolph, Willard N. Failing and James C. Allanson, a co-partnership d/b/a Slocum-Dickson Clinic, Defendants-Appellants-Respondents.

Supreme Court, Appellate Division, Fourth Department.
Oct. 30, 1957.

Action by doctor, who had been expelled from partnership of physicians practicing group medicine in city for declaration in respect to his right to practice medicine and surgery within two cities and environs, wherein defendants asked that doctor be enjoined from practicing medicine in cities in accordance with terms of restrictive covenant. The Oneida Equity Term, Henry A. Hudson, J., adjudged that restrictive covenant was void as against public policy and that expulsion was unwarranted and constituted breach of contract and denied defendants' prayer for injunction and defendants appealed, and plaintiff appealed from a part of judgment. The Supreme Court, Appellate Division, McCurn, P. J., held that covenant was not void but that expulsion of doctor had been wrongful and constituted such breach of partnership agreement as to preclude defendants from obtaining equitable relief of injunction to enforce rest.ictive covenant.

Judgment modified to declare validity of restrictive covenant and as so modified affirmed.

See also, 3 A.D.2d 981, 162 N.Y.S.2d 681.

1. Contracts ⇐246

Where doctor's contract with partnership restricted doctor, after termination of his membership in partnership from practicing in designated territory and subsequently all partners signed new partnership contract, which did not contain such covenant, but provided that all provisions in contracts theretofore made between partnership and individual partners were continued, except as they conflicted with provisions of new contract, there was no conflict as to restrictive covenant, nor any ambiguity in respect thereto and restrictive covenant in prior contract was not waived or terminated.

2. Contracts ⇐116(2)

The validity of contract, which restricts competition by a former associate of a physician, depends gen lly on whether restrictive covenant is necessary for the protection of th ovenantee's property and good

covenant invokes personal hardship upon covenantee does not in itself invalidate the promise.

3. Contracts ⇐117(5)

Covenant, in partnership agreement of physicians practicing group medicine in city, that upon termination of a partner's membership he would not practice medicine or surgery in two cities or within radius of 25 miles therefrom was valid.

4. Partnerships ⇐225

Partners have no common law or statutory right to expel or dismiss another partner from the partnership, they may, however, provide in their partnership agreement for expulsion under prescribed conditions which must be strictly applied.

5. Appeal and Error ⇐991

In action by doctor, who had been expelled from partnership of physicians on ground of incompatibility, for declaration in respect to his right to practice within two cities and environs, question whether there had been incompatibility justifying expulsion within meaning of partnership agreement was one of fact for trial court.

6. Partnership ⇐225

Where partnership agreement of doctors practicing group medicine provided that partner might be expelled, doctor refused to sign declaration of intention relating to proposed building program, and motion asking for doctor's resignation was carried at meeting of partners, action of other partners was the equivalent of an expulsion within contract.

7. Partnership ⇐225

Where members of physicians' partnership practicing group medicine, to determine incompatibility of one doctor, requested that he sign or refuse to sign declaration of intention with respect to building program to which he had previously objected, test imposed was not a fair or proper test of doctor's incompatibility, within partnership agreement that a partner might be expelled for the partnership good, which should include incompatibility.

8. Injunction ⇐109
Partnership ⇐232

Demand at meeting of members of partnership operating clinic for resignation of one doctor from partnership upon an improper basis and subsequent expulsion of partner constituted such breach of partnership agreement as to preclude remaining partners from obtaining equitable relief of injunction to enforce covenant restricting doctor, upon termination of his membership, from practicing in designated area, and doctor

Williams & Williams, Utica (Roger H. Williams and Salvador J. Capecelatro, Utica, of counsel), for plaintiff-respondent-appellant.

Evans, Pirnie & Burdick, Utica (Hugh R. Jones and Arthur W. Evans, Utica, of counsel), for defendants-appellants-respondents.

Before McCURN, P. J. and VAUGHAN, KIMBALL, BASTOW and GOLDMAN, JJ.

McCURN, Presiding Justice.

The plaintiff, a physician, is a former partner in the Slocum-Dickson Clinic, a partnership of physicians practicing so-called "group medicine" in the City of Utica.

Plaintiff entered the partnership pursuant to an agreement dated January 1, 1949 covering a period of two years and on January 1, 1951 entered into a new agreement unlimited as to time. Both agreements contained a covenant restricting plaintiff upon termination of his membership in the partnership from practicing in the City of Utica or its environs. The 1951 contract specifically provided that upon termination of his membership in the partnership plaintiff would not practice medicine or surgery in the Cities of Utica or Rome or within a radius of twenty-five miles therefrom. In June, 1954 plaintiff was expelled from the partnership. On July 1st following his expulsion he brought this action praying, among other things, for a declaration in respect to his right to practice medicine and surgery within the Cities of Utica and Rome and environs. The answer of the defendants joins in the prayer for declaration as to the rights of the parties and asks that plaintiff be enjoined from practicing medicine and surgery in the Cities of Utica and Rome and within a radius of twenty five miles therefrom for a period of five years in accordance with the terms of the restrictive covenant already mentioned.

The trial court has held that the restrictive covenant is unduly harsh and void as against public policy. It held, however, that in any event the expulsion of the plaintiff from the partnership was without justification and consisted of such a breach of the partnership agreement as not to entitle the defendants to the equitable relief of injunction. The defendants have appealed from the entire judgment and the plaintiff cross-appeals from certain portions thereof.

[1] Plaintiff argues on his appeal that the restrictive covenant in his 1951 contract with the other members of the partnership was waived or terminated by reason of the fact that a new basic partnership agreement executed by all of the partners in 1953 made no reference to the restrictive covenant. It appears that since the beginning of the partnership each new member at the time he is taken into the partnership. Examination of the several agreements in evidence discloses that in each instance the contract between the partnership and the individual member contained the same restrictive covenant as in plaintiff's contract with the other members. It discloses, also, that the so-called basic partnership agreement has never contained the restrictive covenant. Examination of the 1953 basic partnership agreement which was executed by all of the then members of the partnership, including the plaintiff, contains a provision that "all provisions in contracts heretofore made between the partnership and individual partners are continued, except as they conflict with the provisions hereof". We find no conflict as to the restrictive covenant nor any ambiguity in respect thereto and reach the conclusion that the trial court correctly held that the restrictive covenant in the 1951 contract has not been waived or terminated.

Contracts restricting competition by a former associate of a physician have received approval in the courts of this state and in other jurisdictions. Foster v. White, 248 App.Div. 451, 290 N.Y.S. 394, affirmed 273 N.Y. 596, 7 N.E.2d 710; Keen v. Schneider, 202 Misc. 208, 114 N.Y.S.2d 126, affirmed 280 App.Div. 954, 116 N.Y.S.2d 494; Beam v. Rutledge, 217 N.C. 670, 9 S.E.2d 476; Whitehill v. Bradford (1952) 1 All Eng.Law Rep. 115.

[2] While each case is dependent upon its own particular facts and circumstances the validity of such a restrictive covenant depends generally upon whether it is necessary for the protection of the covenantee's property and good will or whether it is unreasonable, unjust or oppressive to the covenantor—whether it offends public policy. We see no difference in principle where physicians are concerned, whether the covenant is imposed upon an employer-employee relationship or a partnership relationship. The fact that the performance of such a covenant invokes personal hardship upon the promisor does not in itself invalidate the promise. No argument is made here that the time is too long or that the restricted area is too great.

It is to be noted that prior to the time the plaintiff joined the Clinic in 1949 neither he nor his family had ever been residents of Utica. He had not practiced medicine or surgery any place in the State of New York. His prior medical practice had been in connection with a hospital in Boston, Massachusetts. The partnership operating the Clinic had been in operation since 1938 and had earned a reputation for professional competence and had developed the good will of the community. It was inevitable that the plaintiff in the course of his duties as a partner in the Clinic would have patients of the Clinic and would acquire their

thaining partners would thereby suffer a loss of patients and good will. A profession partakes on its financial side of a commercial business and its good will is often a valuable asset. See Styles v. Lyon, 87 Conn. 23, 86 A. 564.

[3] The circumstances in this case are quite analogous to the circumstances in Foster v. White, 248 App.Div. 451, 290 N.Y.S. 394, affirmed 273 N.Y. 596, 7 N.E.2d 710, and Keen v. Schneider, 202 Misc. 298, 114 N.Y.S.2d 126, affirmed 280 App.Div. 954, 116 N.Y.S.2d 494, and in our view the legal principles enunciated in those cases are likewise applicable here. The hardship imposed on the plaintiff is not when balanced with the needs of the defendants sufficient to invalidate the covenant. We conclude that the covenant is valid and that the judgment appealed from should be modified in that respect.

[4, 5] However, if the defendants would enforce the covenant by injunction they must justify their dismissal of the plaintiff from the partnership. Partners have no common law or statutory right to expel or dismiss another partner from the partnership. They may, however, provide in their partnership agreement for expulsion under prescribed conditions which must be strictly applied. See Mechem, Elements of Partnership (2d Ed.) § 368; George on Partnership, p. 309. The present partnership agreement provides:

"(C) A partner may be expelled from the Clinic by a four-fifths vote in the regular manner of voting of the partnership, but excluding the vote of the expellee:

"1. For cause * * *

"2. For the good of the partnership, which shall include incompatibility or any other factor or quality or relationship."

The defendants here expelled the plaintiff from the partnership for the good of the partnership based upon his alleged incompatibility. Whether or not there was incompatibility justifying expulsion within the meaning of the partnership agreement presented a question of fact for the trial court. Gray v. Shepard, 147 N.Y. 177, 41 N.E. 500.

The question of plaintiff's incompatibility hinges largely on his reluctance to participate in a proposed building program. The senior partners proposed the purchase of real estate and the erection thereon of a building for the use of the Clinic. No definite estimate of the cost of such a venture had been computed but Dr. Charles Dickson, one of the proponents of the proje., testified that he thought it would involve an expenditure of from $200,000 to $300,000. Various conferences over a period of months eventually result[illegible]n all of the partners, except the plaintiff, agreeing to participate in such a building program. As the discussion progressed and plaintiff cont[illegible]ed to question the wisdom of the conflict in opinion caused concern as to plaintiff's status with respect to the restrictive covenant in case he became disassociated from the partnership. Early in June, 1954 the defendants decided to test plaintiff's compatibility by calling upon him to execute along with the other partners a so-called declaration of intention. The declaration of intention was a contract whereby each of the partners among other things declared his intention to participate fully in the development and execution of "any financial program for the implementation of such office building plan and to that end within his financial competence to accept and discharge all financial, professional and other personal obligations which may reasonably be expected of him by the other parties". It also contained a reaffirmance of the restrictive covenant already discussed.

At a partnership meeting held on June 7, 1954 the plaintiff presented and read to the meeting a counter declaration of intention by the terms of which he agreed:

"1. To do all I can by way of energy, time and ability to quickly bring into being a site satisfactory to the group and thereafter to consumate our group building program.

"2. To support the building program to the extent of my proportionate interest in the partnership and to be more explicit, I would contribute my pro-rated equal share as divided among the number of full partners in the group."

Plaintiff refused to sign the declaration of intention which had been signed by the other members of the partnership, whereupon he was informed that the other partners had agreed in case of his refusal to ask for his resignation from the partnership. A motion was carried asking for his resignation, all voting in the affirmative except the plaintiff. Plaintiff then stated that his resignation would be forthcoming unless the group wanted to wait a month for further consideration. The suggestion of further consideration was turned down and plaintiff thereafter on June 11th submitted his written resignation to take effect six months hence.

According to the claim of the defendants, the plaintiff at a conference on June 10, 1954 made a statement to the effect that he intended to practice in Utica. The record presents a conflict in testimony as to whether such a statement was made. The trial court who saw and heard the witnesses refused to find that such a statement was made. However, at a meeting of the partnership on June 16th subsequent to plaintiff's resignation at which the plaintiff was given notice to attend and did attend, he was asked w[illegible]ther or not h[illegible] intended to practice in Utica and replied that he had not m[illegible]up his mind; he refused to give a categorical an-

not be accepted and a resolution was passed expelling him from the partnership.

[6, 7] We regard the action of the defendants at the meeting of June 7th at which time the plaintiff was asked to present his resignation as the equivalent of an expulsion. He had no reasonable alternative to do otherwise than comply. See I. Edward Brown, Inc., v. Astor Supply Co., 4 App.Div.2d 177, 164 N.Y.S.2d 107, 108, 109. Despite the plaintiff's refusal to sign the declaration of intention his own so-called declaration of intention constituted a broad agreement to go along with the building program. His former opposition to the program, as we read the record, does not establish incompatibility. It appears to have been based upon an honest belief that the proposed building program was an improvident undertaking. In any event, it was a matter of business judgment involving among other things the financial ability of each individual partner to underwrite his proportionate share of a substantial investment and his willingness to assume the risk. It was obviously a matter upon which reasonable minds might differ. Moreover it was the subject of a new and independent agreement between the partners and not within the scope of the partnership agreement. There was no need to reaffirm the restrictive covenant for as had been indicated the restrictive covenant was already in force and effect. The test applied at the meeting of June 7th to determine the plaintiff's incompatibility, that is, whether he would sign or refuse to sign the declaration of intention in the form presented by the defendants, was not, in our view of it, a fair or proper test of his incompatibility within the purview of the partnership agreement.

We have not overlooked the arguments of defendants' counsel based upon the evidence as to plaintiff's expressed views upon financial arrangements both prior to and subsequent to the 1953 partnership agreement. We do not regard the plaintiff's attitude in these matters as unreasonable or arbitrary.

[8] We conclude that the demand at the meeting of June 7th for plaintiff's resignation from the partnership and the subsequent expulsion at the meeting on June 16th constituted such a breach of the partnership agreement as not to entitle the defendants to the equitable relief of injunction to enforce the restrictive covenant. Likewise, plaintiff may not be deprived of his interest in the accounts receivable.

The judgment appealed from should be modified so as to declare the validity of the restrictive covenant and as so modified affirmed without costs.

Judgment modified on the law and facts in accordance with the opinion and as modified affirmed, without costs of these appeals to any party.

All concur.

J. Bradford MILLET, Plaintiff-Respondent, v. Millard M. SLOCUM et al., a co-partnership, d/b/a Slocum-Dickson Clinic, Defendants-Appellants.

Court of Appeals of New York.
June 25, 1958.

Appeal from Supreme Court, Appellate Division, Fourth Department, 4 A.D.2d 528, 167 N.Y.S.2d 136.

Doctor, who had been expelled from partnership of physicians practicing group medicine in city, brought action against the other members of the partnership for declaration with respect to his right to practice medicine and surgery within two cities and environs, and the other members of the partnership filed a counterclaim asking that the doctor be enjoined from practicing medicine in the two cities and environs in accordance with the terms of a restrictive covenant.

The Oneida Equity Term, Henry A. Hudson, J., entered judgment that the restrictive covenant was void as against public policy and that expulsion of the doctor was unwarranted and constituted a breach of contract, and denied the prayer for injunction, and all parties appealed.

The Appellate Division, McCurn, P. J., modified and affirmed the judgment and held that the restrictive covenant was not void, but that expulsion of doctor had been wrongful and constituted such a breach of partnership agreement as to preclude the other members of the partnership from obtaining equitable relief of injunction to enforce the restrictive covenant.

The other members of the partnership appealed to the Court of Appeals, contending that the restrictive covenant was valid, and that the other members of the partnership properly exercised their right to terminate the doctor's membership in the partnership, and that the other members of the partnership were entitled to enforcement at law of contract provisions as to accounts receivable.

Evans, Pirnie & Burdick, Utica (Hugh R. Jones and Arthur W. Evans, Utica, of counsel), for defendants-appellants.

Williams & Williams, Utica (Roger H. Williams and Salvador J. Capecelatro, Utica, of counsel), for plaintiff-respondent.

Judgment affirmed, with costs.

All concur.

(Partnership Litigation — Group B) *
Exhibit B-16 — Notes on Appeal Strategy.

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Exhibit B-16

The Order

1. Challenge the Award

2. Challenge the Order

3. Request Award be Set Aside and a New Arbitration Ordered to Settle All Issues in the Dispute

1. Challenge the award (contradicts Lawton's move to confirm)

(1) The award rendered not responsive to the demands of either party.

(2) The award is a dissolution imposed by the Arbitrators.

(3) Neither side asked for dissolution.

(4) Fahey asked for

a. Damages for the wrongful injunction.

b. Clarification of his partnership interest.

(5) McKinney asked for

a. Verification of a right to expel Fahey.

Note - Millet v. Slocum says partner cannot expel co-partner without demonstrating grounds before a trial body which decides if the partner should be expelled. There is no arbitrary power to expel.

b. If no grounds to expel, verification of a right to buy out Fahey on the same grounds (the best interest of the Partnership).

Note - Again, Millet v. Slocum says a forced buyout provided in the agreement is equivalent to expulsion, and the expelling partners have the burden of showing justifiable grounds.

(6) The Arbitrators did not rule on any of the (specific) demands presented by either party.

Although they may not be required as a rule to give reasons for their rulings on demands, they cannot ignore the demands themselves -- This makes the arbitration itself a pointless procedure.

Even if they had ruled in "favor" of McKinney, Millet v. Slocum implies they do have to give reasons to justify an expulsion that will result in a denial of economic benefits of part ownership in a successful partnership business -- especially when the success of the business was the direct result of the efforts of the expelled partner.

(7) The specific award handed down by the Arbitrators did not decide (or state) that Fahey was either expelled or bought out by McKinney within the meaning of the terms of the partnership agreement (upon which both parties were relying with their own arguments about its meaning and the effect of existing law upon that meaning). The award merely stated that

a. Fahey would cease to be a partner (without giving any date this would or had occurred).

b. McKinney would pay Fahey a sum of $170,000 (without giving any basis for arriving at that sum, and without any evidence whatsoever being taken regarding the value of the Partnership and Fahey's share therein.)

By being silent on the question of whether Fahey was expelled or bought out, and on what grounds, the arbitrators took it upon themselves to convert the demands and arguments being waged by the partners under the partnership agreement into a case of dissolution, which was totally outside the scope of their authority since

a. Neither party asked for a dissolution.

b. No evidence was submitted to establish the value of a dissolution award.

The arbitrators did not rule on any one of the demands put before them by the parties.

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2. Challenge the Order

(1) The order requested compounds the error of the arbitrators by making an assumption about the award (which the court absolutely can not do). What the order assumes, and what the arbitrators deliberately, and erroneously, refused to say or rule on -- is that Fahey was removed under the contract, and that grounds existed for this removal.

(2) We submit the reason the arbitrators acted in this manner is that

a. They knew from the evidence that there were no grounds that would justify Fahey's removal, but also

b. They took it upon themselves to decide that these 2 partners should no longer work together, and then they picked a dollar figure out of thin air that they thought would placate Fahey to get him out of the partnership.

(3) We insist that the arbitrators had no authority whatsoever, and no legal or equitable justification whatsoever, in coming to this kind of conclusion. There is absolutely no ground in law or equity, which can force the separation of 2 partners just because they might not get along together. Economic rights are not based on such whimsical emotional grounds.

(4) We now have the grotesque situation of an arbitration board having swept all the specific disputes brought before it under the rug, and coming up with their own unauthorized version of what justice should be in this case.

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What makes this grotesque is that the court is now being urged to assume the arbitrators meant what they deliberately avoided ruling on -- that Fahey was justifiably expelled from the partnership.

The amount of the award itself cleary shows the arbitrators did not rely on Article 12 of the partnership agreement to arrive at their ruling. Consequently, the opposite assumption about Mr. Fahey's status is equally valid -- that Fahey was not removed or expelled legally from the partnership, and consequently was separated from the partnership on some mysterious unexplained ground by the Arbitrators (not by McKinney), and compensated in accordance with some mysterious unexplained criteria not related to the partnership agreement.

In any event, the adjudication of Mr. Fahey's rights (which must be clearly determined by arbitration as provided in the partnership agreement) cannot conceivably be considered satisfied by an ambiguous award that is clearly open to 2 opposite assumptions and conclusions regarding Fahey's status and rights as a partner.

This kind of award cannot be permitted to stand.

3. Request that Award be Set Aside and a New Arbitration Ordered to Settle all Issues in the Dispute

The arbitrators were acting under a court order to settle all issues in the dispute. Instead, they settled none of the issues.

We therefore respectfully request that a new arbitration be ordered with a specific admonition to settle all issues raised by the parties, and only the issues raised by the parties.

It is not the function of an arbitration board to decide whether a partnership will be a happy one or an unhappy one. It is only to settle the arguments between the parties.

We also request that the order for the new arbitration include the following provisions:

(1) If Fahey is expelled, it must be for grounds stated by the arbitrators (Millet v. Slocum)

(2) If Fahey is to be bought out

a. It must be for grounds stated by the arbitrators (Millet v. Slocum)

b. Evidence must be taken to establish the value of the partnership, and Fahey's interest therein.

c. A clear and separate ruling must be made on the effect of the depreciation provision of the partnership agreement on the interests held by McKinney and Fahey.

(3) If Fahey is not expelled or bought out

a. Evidence must be taken to establish the value of the partnership, and Fahey's interest therein.

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b. A clear and separate ruling must be made on the effect of the depreciation provision of the partnership agreement on the interests held by McKinney and Fahey.

c. A clear and separate ruling must be made regarding the respective managerial control over the business to be exercised by each party.

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Re U.S. v. Thomas Fahey

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ARBITRATION TRIBUNALS OF THE
AMERICAN ARBITRATION ASSOCIATION

- -

In the Matter of the Arbitration

of

THOMAS M. FAHEY

-and-

WALKER McKINNEY

and

CASTLE REST NURSING HOME

and

GEORGE A. SIMPSON

Case Number: 15 10 0032 69

- -

BRIEF ON BEHALF OF THOMAS M. FAHEY

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Statement

No real purpose can be gained by preparing a detailed summary of all the testimony given in this hearing. Of much more benefit to the Board of Arbitrators it is believed would be a brief summary followed by a detailed outline of the relief requested and the reasons why said relief should be granted both under the facts and the law applicable.

Facts

Despite McKinney's deliberate attempt to mislead first Judge Aronson and now this Board into believing otherwise, the testimony was overwhelming and conclusive that the idea of converting the old Syracuse General Hospital into a nursing home originated with Fahey and that said idea came to fruition largely through Fahey's efforts and expertise. McKinney's contribution was limited to investing capital. This is not to minimize the importance of McKinney's role but to place it in proper perspective.

Once the original four partners got together and agreed to go ahead with the project, they entered into a written memorandum of understanding (Ex. A) which clearly shows an intent that it was to be a 50-50 proposition. Fifty percent (50%) was to go to McKinney and Simpson for financing and fifty percent (50%) to Fahey and Metzger for services. This general intent was carried over in all subsequent agreements (Exs. B, E and F) including the final agreement dated November 16, 1965 (Ex. G).

Almost exclusively through Fahey's efforts, the nursing home developed into a going profitable business. During the difficult period of construction, the obtaining of permits from regulating agencies, staffing, working out initial "bugs" and expanding the home to include a residential wing, little or no difficulties arose between McKinney and Fahey. Fahey negotiated all the contracts, both for construction and operation of the home, all without consultation or direct control. All expenses were paid by checks signed exclusively by Fahey. McKinney was content to rely on his periodic visits, at which time he was given full free access to the home and its records.

It was only after the nursing home had settled down into a stable and profitable business did problems develop. As soon as the home started, Fahey on behalf of the partnership, negotiated a $150,000 loan. The purpose of this loan was to provide working capital of which there was a shortage at that time. Contrary to this purpose, McKinney immediately insisted upon a withdrawal of $100,000 of said monies, $85,000 of which went to him and reduced his capital account to a negative balance. Fahey's objection that said withdrawal was in violation of the terms of the loan agreement was ignored.

Subsequently, McKinney repeatedly requested that $600.00 per month be paid to Attorney William Murray, ostensibly for services rendered to the partnership but in reality for personal services for McKinney. Fahey refused. It was only then did McKinney begin to exert pressures upon Fahey and create spurious issues by demanding written reports, co-signing of checks, etc.

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During this period, McKinney, to strengthen his minority holdings, without any prior consultation whatsoever with Fahey or Dr. Simpson, authorized his attorney, William Murray, to enter into secret negotiations with Metzger to purchase his interest. Attorney William Murray, with the knowledge and consent of McKinney, negotiated in secret to purchase Metzger's interest for a flat sum of $25,000. Murray was unable to come up with the money and consequently, Mrs. Jane McKinney, Walker McKinney's mother, was substituted as purchaser. Last minute ratification by the remaining parties was attempted, but upon their refusal to consent (as no consent was required), Walker McKinney ordered the sale to proceed without the remaining partners' consent. Mrs. McKinney's check was made payable to the partnership and then endorsed over to Metzger. No monies were deposited, however, into the partnership account and no record was made in the partnership books.

After learning of the early contract between Attorney Murray and Metzger to purchase Metzger's interest, Fahey and Dr. Simpson began negotiating for the direct purchase of Dr. Simpson's interest to protect Fahey's position in the partnership. It was following the completion of said sale that McKinney resorted to the drastic remedy of secretly obtaining an ex parte order (without disclosing the existence of the arbitration clause in the partnership agreement), restraining Fahey from acting as administrator or even exercising his basic rights of inspection given to a partner pursuant to the Partnership law (§ 41). Following a hearing, Judge Aronson vacated

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Exhibit C-1 — First Final Brief on Behalf of Fahey.

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POINT I

THE POWER OF THIS BOARD TO DETERMINE THE DISPUTES BETWEEN THE PARTIES

Of initial importance are the rights, powers and duties of this Board to determine the issues herein. Until such a clarification is made concerning this Board's powers and jurisdiction, it is fruitless to speak of issues to be decided and relief requested.

The partnership agreement (Art. 15) specifically provides that all disputes arising out of or in any way relating to the agreement shall be settled by arbitration in accordance with the rules of the American Arbitration Association. By so agreeing, the parties are now bound by all the rules, procedures and powers that are inherent to an arbitration proceeding. The court in Application of Spectrum Fabrics Corporation, 285 App. Div. 710 aff'd 309 NY 709, summed it up as follows:

> "When parties agree to arbitrate, they agree to waive the rules of evidence and the inexorable application of substantive rules as well. This may not always be wise, but it is within the powers of the contracting parties and it is the import and essence of an arbitration agreement. It distorts the purpose of arbitration for courts to censor the issues that arbitrators may consider before the courts will permit an arbitration to proceed... The fact is that an agreement to arbitrate, as authorized by statute, is a contractural method for settling disputes in which the parties create their own forums, pick their own judges, waived all but limited rights of review or appeal, dispense with the rules of evidence, and leave the issues to be determined in accordance with the sense of justice and equity that they may believe reposes in the breast and minds of their self-chosen judges. All this they choose for themselves, subject only to the statutory grounds for vacatur of the award,

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as set forth in Section 1462 of the Civil Practice Act. This violates no policy. The statute authorizes it. Its wisdom is not for the courts to dispute."

In the early case of Fudickar v. Guardian Mutual Ins. Co., 62 NY 392 (1875), the Court of Appeals very clearly and succintly set forth the duties and powers of an arbitrator and the powers of the court to review their awards.

> "The arbitrator is a judge appointed by the parties; he is by their consent invested with judicial functions in the particular case; he is to determine the right as between the parties in respect to the matter submitted, and all questions of fact or law upon which the right depends are, under a general submission, deemed to be referred to him for decision. The court possesses no general supervisory power over awards, and if arbitrators keep within their jurisdiction their award will not be set aside because they have erred in judgment either upon the facts or the law."

To determine the jurisdiction of the arbitrators, you must in the first instance look to the written agreement. If the agreement contains a broad arbitration provision, then the arbitrator may decide all issues arising under said contract. See Exercycle Corp. v. Maratta, 9 NY 2d 329, 336, wherein the Court stated:

> "Where there is a broad provision for arbitration ... arbitration may be had as to all issues arising under the contract."

See also Cohen v. Cohen, 17 AD 2d 279 at 284:

> "Generally speaking, in the absence of some express restriction or reservation in connection with a written submission, the parties thereto are presumed to have agreed "that everything, both as to law and fact, which is necessary to the ultimate decision, is included in the authority of the arbitrator." (See 6 C.J.S., Arbitration and Award, §48). There being no expressed intent to the contrary, a submission is deemed to embrace all issues of fact and law with reference to the controversies submitted. (See Matter of Wagner (Russeks Fifth Ave.), 281 App. Div. 825; Matter of Samuel Adler, Inc. (Local 584), 282 App. Div. 142; Matter of Pence

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Fabrics (Louis Dogopulsky, Inc.), 1 A D 2d 659; Matter of Plotkin Foods, (Britton Foods), 14 AD 2d 328, 334.) All such issues, which are not expressly or by plain implication excluded from their domain, are to be determined by the arbitrators."

There can be no question but that the contract in the present case contains a very broad arbitration clause, to wit:

> "Any claim or controversy arising out of or in any way relating to these Articles or the breach or application thereof shall be settled by arbitration in accordance with the rules of the American Arbitration Association then in effect. Any arbitration award or determination made pursuant to this Section shall be final and binding upon all parties hereto and their legal representatives, and judgment thereon may be entered in any court having jurisdiction thereof."

This being so, this Board of Arbitrators possesses full authority to decide all issues raised between the parties and is not limited to the isolated question whether or not Fahey was properly expelled from the partnership.

As seen by the foregoing, not only is the jurisdiction of this Arbitration Board very broad, but so is its authority to decide and determine the issues before it. In some ways, an arbitrator is like a judge, i.e. he should possess all the desirable attributes of the judiciary such as impartiality, fairness, etc. Matter of Friedmen, 215 App. Div. 130; Matter of A. E. Fire Ins. Co. v. N.J. Ins. Co., 240 NY 398,405. In all other respects, however, an arbitrator possesses powers far greater than those given to a judge. A judge is bound by the restrictions imposed by law such as evidentiary rulings, materiality, and even the law itself. An arbitrator is not so restricted. In Kerein v. Rabin, 29 AD 2d 351,356, the Court stated:

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> "Moreover, arbitrators are not hampered in the discharge of their duty by rules of evidence, on the body of case and statutory law governing the prosecution of actions ... Nor are they restricted to a consideration of only such evidence as the parties see fit to produce, unless, of course, the submission so provides." (Matter of Springs Cotton Mills, (Buster Boy Suit Co.), 275 App. Div. 196, 209, 88 NYS 2d 295,298 Aff'd 300 NY 586,89 NE 2d 877) ... In a valid submission, questions of law and fact are for the arbitrators. 'When parties agree to arbitrate, they agree to waive the rules of evidence and the inexorable application of substantive rules as well.' (Matter of Spectrum Fabrics Corp. (Main St. Fashions), 285 App. Div. 710,714, aff'd 309 NY 709; Matter of Staklinski (Pyramid Elec. Co.) 6 AD 2d 565, aff'd 6 NY 2d 159.

The rules of the American Arbitration Association, recognizing this fact, specifically provide that the strict rules of evidence do not apply nor does materiality play a part in deciding whether evidence should be received or not. Most important, however, is the rule that an arbitrator is not bound by any law be it statutory or case law but rather is free to fashion the law to fit the facts before him. So stated the Court of Appeals in Matter of Exercycle Corp., 9 NY 2d 329,334:

> "Whether the issue is one involving interpretation or law or fact or all three, it is for the arbitrators and, as long as they remain within their jurisdiction and do not reach an irrational result, they may fashion the law to fit the facts before them."

The doctrine of stare decisis has no applicability in an arbitration proceeding. The arbitrators decide what the law should be in each particular case. They determine what rules of law are appropriate under the circumstances. See Granite Worsted Mills v. Arenson Coven Ltd., 29 AD 2d 303:

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> "Once it is ascertained that the parties broadly agreed to arbitrate a dispute arising out of or in connection with the agreement, it is for the arbitrators to decide what the agreement means and to enforce it according to the rules of law which they deem appropriate in the circumstances."

This rule is not surprising when it is recalled that in many instances the arbitrators are not lawyers or persons trained in the law. The whole purpose and intent behind arbitration is to avoid the complexities and intricacies that accompany a legal proceeding and to seek a quick, final, just and fair determination. Inasmuch as arbitrators are not bound by the law, it necessarily follows that an award will not be reversed by a court merely because the arbitrators made a mistake in the law or in fact. Granite Worsted Mills v. Aronson Cowen Ltd., 29 AD 2d 303; Matter of Colletti 23 AD 2d 245 Aff'd 17 NY 2d 460; Matter of Shevell v. Benson 29 AD 2d 751. See also Matter of Schine Enterprises, NY 2d, Decided February 1970.

In sum, it is clear that the Board of Arbitrators are the sole judges of the facts and law as they decide is applicable and that except for the very limited reasons set forth in CPLR 7511, these rulings are not reviewable. Being non-roviewable, there is no requirement that the Board explain its findings or rulings. In Bay Ridge Medical v. Health Ins. Plan of Greater New York, 254 NYS 2d 616, the court stated at p. 618:

> "The validity of an award is unaffected by the absence of a recital of the reasons for the award (Matter of Willow Fabrics, Inc. (Carolina Freight Carriers Corp.), 20 AD 2d 864, 248 NY 2d 509); and

> an award may not be vacated because the arbitrators did not give their reasons for the award nor set forth their calculations to justify the award. (Matter of Linwood (Sterry), 16 Misc. 2d 488, 491, 176, NYS 2d 492, 494, Aff'd 774, D. 2d 757, 191 NYS 2d 772; Matter of Big V. Const. Corp. (Horowitz), 24 Misc. 2d 145, 156, 192 NYS 2d 721,733, Aff'd 14 AD 2d 817, 218 NYS 2d 53). In question of an arbitrator for the purpose of determining the processes by which he arrives at an award finds no sanction in law." (Matter of Weiner Co. (Freund Co.), 2 AD 2d 341,342; 155 NYS 2d 802, 805, supra). Supra, 254, NYS 2d 616,618, 22 AD 807;

See also Armell Wholesale Corp. v. Jomar Products, Inc. 21 NY 2d 621.

All of this is not to say that the law is to be ignored. On the contrary, the Partnership Law and the very few cases previously cited in our earlier memorandum should serve as a guide in reaching a decision in this matter. In either case, however, i.e. at law or in arbitration, the results should be the same. The cases hold that these disputes are equitable in nature and that all the rules of equity apply. (See previous memos). But because this is an arbitration proceeding and cases are not controlling, this memorandum will dwell on the disputes at issue and the reasons why Fahey should be granted the relief requested rather than on cases most of which really have no direct applicability.

POINT II

MR. FAHEY WAS WRONGFULLY EXCLUDED FROM THE PARTNERSHIP AS PARTNER-ADMINISTRATOR

In answer to McKinney's "motion to dismiss", Fahey submitted a memorandum in opposition thereto. In said motion,

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it will be recalled it was contended rather cavalierly by McKinney that he, acting as senior partner, had the dictatorial right to dismiss Fahey both as administrator and as a partner and that said right was not subject to review. McKinney's contention was that he alone as "senior partner" was the judge of whether Fahey's conduct adversely affected the partnership and once that determination was made, Fahey was expelled with forfeiture of all his rights, titles and interests in the partnership. To but state such a proposition is to expose it absurdity.

In Fahey's opposing memorandum, it was shown that such clearly was not the law. No purpose would be gained by repeating the arguments and cases contained in said memorandum but rather they are adopted into this memorandum as if fully set forth herein.

McKinney's next line of attack was to claim dismissal under Article 12. Under this provision, it was claimed that McKinney possesses the same dictatorial power but that he must give ninety (90) days' notice and pay for Fahey's interest. Again, as pointed out in our earlier memorandums, such is not the law in New York State. Regardless of the wording of the partnership agreement, one partner cannot arbitrarily expell another or force his involuntary withdrawal from the partnership. Whether a partner should for sufficient reason be expelled or compelled to withdraw is a question of fact for determination by a court or Board of Arbitrators. (Millet v. Slocum, 4 AD 2d 528).

The evidence produced at this hearing would indicate that Fahey's only real offence was that he was so successful in developing and operating the nursing home into a profitable business that McKinney could not resist an attempt first, to confiscate Fahey's interest under Article 11 and failing in that, to appropriate his interest under Article 12 at a bargain price.

When one considers the nature of the allegations made against Fahey and then compares these with the wrongs committed by McKinney himself, the purpose of McKinney's actions become very clear. McKinney attempts to justify his attack on Fahey with diversionary, frivolous and insignificant charges.

The first charge concerns Fahey's alleged failure to file written weekly reports. During the entire construction period and initial operational period, Fahey exercised wide powers and despite the large amounts being authorized and spent, Fahey did not submit written reports. Later, after the mortgage was obtained and construction started, all general and detailed information about the project was made available to McKinney through monthly visits, letters, reports, phone calls, and other meetings. It was only after the nursing home began to operate efficiently and produce revenues did McKinney, in an effort to create issues, first asked and later demanded written reports. The evidence totally failed to show the necessity for these written reports. Not one instance of mismanagement was disclosed that would justify time-consuming preparation of weekly reports.

(Arbitration Briefs — Group C) *
Exhibit C-1 — First Final Brief on Behalf of Fahey.

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interest. It was only after a deal had been agreed upon in writing (Ex. TTT) was Dr. Simpson advised of it. Dr. Simpson was mindful of the pressures then being brought upon Fahey by McKinney. McKinney had in fact in February, 1969 asked Dr. Simpson to participate in a coup d'etat to oust Fahey at that time. Dr. Simpson refused to be a part of such a scheme. This was no longer a partnership that he wanted to be a part of. Mindful of his past difficulties in obtaining assurance of fair dealing from McKinney and McKinney's strong-arm tactics, it was only natural that he turn to Fahey to negotiate a sale.

From Fahey's position, said purchase was entirely justifiable. At no time prior to the agreement to purchase Metzger's interest did McKinney or Murray notify either Dr. Simpson or Fahey of said intent. What could be more important than this--a change in the makeup of the partnership itself--nevertheless, McKinney chose to act clandestinely. This despite the fundamental principal of partnership law that a partner is in a fiduciary relationship with his other partners requiring the utmost in fair dealing and disclosure.

From that poin' on, a decided change came over McKinney and his attitude towards Fahey. McKinney for the first time became demanding and arbitrary in his actions. If Dr. Simpson, who was known to be interested in selling his interest, were to sell out to McKinney, then Fahey as a practical matter, would be almost helpless in his defense against a total McKinney

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takeover. Inasmuch as McKinney in reality bought out Metzger's interest, so then did Fahey feel justified in purchasing Dr. Simpson's interest to better protect himself. The old adage of what is sauce for the goose is sauce for the gander, while not strictly of legal origin, has marked applicability to the present case.

We submit that none of these charges by McKinney or the facts they have revealed can justify the Arbitration Board expelling Fahey from the partnership or forcing him to be bought out by the partnership.

Compare the contrived charges made against Fahey with the actual misconduct of McKinney. McKinney made irresponsible and improper demands upon Fahey relative to financial matters. At a time when the partnership needed working capital to operate efficiently, Fahey obtained a loan of $150,000 for this purpose but as soon as the money was received, McKinney demanded that $100,000 of it be distributed to Dr. Simpson and himself which reduced their capital account to a negative balance. Not only was this in direct violation of the loan agreement itself, but it placed a severe financial drain upon the partnership.

McKinney first requested, later urged, and finally demanded that his personal attorney, Murray, be paid $600.00 per month out of partnership funds for personal work unrelated to partnership business. (How much closer this is to larceny than the temporary use of 3 'TV' sets). Fahey steadfastly refused to be a part of this scheme and did not pay the retainer.

Next, consider McKinney's power play to dispose of Fahey

under the guise of legal sanctity. The agreement itself provided a method of settling disputes. If McKinney was concerned only with a determination whether or not he was entitled to written weekly reports or if all checks should be countersigned by him, instead of attempting to grab the entire partnership, he could have obtained a determination of those limited issues very speedily under the arbitration clause. The failure to do so in itself constitutes a serious breach of the partnership agreement.

On an ex parte application wherein McKinney withheld from the court the existence of the arbitration clause, he obtained a temporary order barring Fahey from participating even in his most basic rights as a partner. Under the guise of this ex parte order, McKinney quickly proceeded to communicate with all persons having dealings with the nursing home advising them that the court had ordered Fahey's removal. No regard was given to Fahey's reputation or standing in the community, even though Murray as a lawyer knew the legal effect of an ex parte order. Even after the court refused to continue the temporary order and denied McKinney's application for a temporary injunction, McKinney nevertheless continued this false character assassination. Most cruel of all was the deliberate dissection and misrepresentation of J. Aronson's order denying McKinney's motion and publishing only those parts which would lead the reader to believe that Fahey had been found to be guilty of grievous wrongdoing, and then posting the same for employee and

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patient consumption (Ex. MMM). Similar misrepresentations were made to banks, business firms and regulating agencies.

To show to what lengths McKinney went to achieve and to justify this takeover, he hired at partnership expense, a private detective to investigate and spy upon Fahey. This not being enough, he violated the law by ordering a telephone tap to be placed upon Fahey's phone (Section 250.05 NY Penal Law). All this proved to no avail. Not one single item of wrongdoing was uncovered.

As previously pointed out, this is an equity action with all the rules of equity applicable. Even at law, the charges themselves are totally insufficient to warrant expulsion or compulsory withdrawal of Fahey. When one considers all the proof and also weighs the equities, the record compells a finding both in fact and law that Fahey was wrongfully expelled as partner-administrator.

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POINT III

FUTURE MANAGEMENT OF THE PARTNERSHIP

We have already shown that no partner or combination of partners, in this or any other partnership, has the power to force the involuntary expulsion or withdrawal of a co-partner; only a trial court or arbitration board can order involuntary expulsion or withdrawal on the basis of a hearing of all the factual considerations concerning the conduct of the particular co-partner.

We have also shown that in this case there are no factual grounds to justify ordering the expulsion or involuntary withdrawal of Fahey, and he should therefore be reinstated with full powers as partner-administrator.

The reinstatement of Fahey raises a fundamental question which we think should be met head-on--the question of the future management of the business.

> Note: McKinney did not request, in his own cross-demand, any declaration regarding clarificiation of management power within the partnership, which is really the heart of the dispute. Instead, he requested only a declaration to have Fahey expelled or be forced to withdraw. McKinney's answer to the basic controversy about management power between the two partners was extremely simple -- eliminate one of the partners, and thereby eliminate the management controversy.

Accordingly, Fahey now requests a declaration clarifying the management power relationship within the partnership. In making this request, we are also submitting to the Arbitration Board a specific request for declarations on management.

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The basic controversy about management power arises from the fact that after 4½ years of continuous management of the partnership by Fahey, under three partnership agreements, McKinney now claims that he is the one who has total management power that entitled him to override his partners and run the partnership as he, McKinney, sees fit.

McKinney bases his contention on his interpretation of one portion of Article 13 of the general partnership agreement.

Fahey contends that McKinney does not have now, and never did have, such power and that he, Fahey, has the right, and is entitled to continue management of the partnership with the same authority that he has had and exercised for 4½ years.

Fahey bases his contention on:

1) The entire Article 13, and the entire general partnership agreement.
2) The pertinent managerial provision of the 3 partnership agreements under which Fahey contends he has had continuous managerial authority.
3) The provisions of other partnership documents relating to management of the partnership.
4) The full scope of management functions performed by Fahey under the 3 partnership agreements.

Fahey also contends that it is a significant fact for the arbitrators to consider in weighing the facts and arguments over managerial power -- that McKinney has always been no more than a minority partner with a 42.5% interest -- that

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Fahey has had the largest single interest of 45% until March 12, 1969 when he increased his interest and is now the majority partner with a 52.5% interest, which presents what we contend is an almost preposterous situation of a minority partner attempting to claim managerial control over a co-partner who is a majority partner (and who has continuously been the managing partner ever since the inception of the partnership).

For the sake of clarity, we are presenting our facts and arguments as follows:

A. Scope of management functions continuously performed by Fahey under the 3 partnership agreements.

B. Evolution of partnership documents relating to management of the partnership.

a. Pre-partnership negotiations -- (Aug. 1964 - Nov. 1964).

b. Memorandum of understanding -- (Nov. 23, 1964)

c. Limited partnership agreement -- (Jan. 4, 1965)

d. Change from limited partnership agreement to general partnership agreement -- (Nov. 16, 1965).

e. Management stipulations of mortgage commitment letter -- (April 8, 1966) -- and mortgage bond -- (Sept. 22, 1966).

f. Additional management stipulation in loan agreement covering loan of $150,000 (Apr. 3, 1968).

g. Special note on bank commitments concerning

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Exhibit C-1 — First Final Brief on Behalf of Fahey.

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(4) He induced the prospective builder, A. J. Cullotti, to place him (Fahey) on the builders payroll at a salary of $400.00 per week, starting in December, 1964.

Note: This was an investment risk by the builder (Ex. IIII). Fahey was on his payroll until May 1967 (except for an intervening period from April 1966 to December 1966 when the partnership paid his salary). The builder paid Fahey a total of $35,130.00 in salaries which were ultimately repaid as part of the construction cost.

(5) He induced the architect, J. Anthony Cappuccilli, to work with him at a modest hourly rate ($10.00 per hour) under a partial risk of delayed payment.

(6) He obtained a commitment from Bill Taylor of Marine Midland Mortgage Marketing to seek a $900,000 mortgage (Ex. NNNN).

Note: This was later dropped to $750,000 after the bank became aware that McKinney had dropped the amount of the morgage contingency in the purchase offer to the hospital (Ex. PPPP).

(7) He engaged a legal firm, Gallagher and Kernan, to act as legal counsel for the partnership.

(8) He had also induced said firm (before he obtained his partners) to act as real estate brokers for the sale of the property as part of the overall-arrangement, and to do all the legal work required for 25% of the brokerage commission (on $350,000), and to turn over 75% of the commission to whatever partnership he would eventually form, thereby generating a capital contribution of his own.

Note: This agreement was documented in the

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first partnership agreement, the memorandum of understanding of 11/23/64 (Ex. A). --

After the closing in September 1966, the money was given to McKinney's attorney Bill Murray, and it stopped there. --

This point is further discussed under "Monetary Disputes".

(9) He prepared, submitted, and resubmitted to the various regulatory agencies -- who were responsible for reviewing and approving the construction plans, operating policies, and business structure of a nursing home under city, state, and federal regulations -- all the technical data and other information required for their examination (both written and oral presentations.)

Note: This process extended over a period of 17 months (Nov. 1964 to Aug. 1966):

4/2/65 -- Application to NY State Dept. Social Welfare.
6/2/65 -- Application to City of Syracuse Planning Dept.
7/17/65 -- Return of application from NY State Dept. Social Welfare on the ground the business entity must be a general partnership, not a limited partnership.
10/15/65 -- Received approval from City of Syracuse Planning Dept.
2/25/66 -- Presentation to Regional Hospital Review & Planning Council
3/15/66 -- Supplementary presentation to the Council
5/23/66 -- Additional information to NY State Dept. Social Welfare
6/21/66 -- Recieved approval of business entity from NY State Dept. Social Welfare
7/22/66 -- Received approval to construct from NY State Dept. of Health
8/11/66 -- Amended application to City of Syracuse Planning to conform with state approval
8/18/66 -- Received approval from City of Syracuse

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(10) He personally conducted (after Marine Midland had evoked the interest of 6 Syracuse banks to participate in the mortgage) a long series of presentations and negotiations at joint meetings with the bank officials and their legal counsel to work out the details of the mortgage provisions to the satisfaction of all six banks.

> Note: This process extended from Nov. 1964 to April 8, 1966, when a detailed mortgage commitment was issued for $750,000 over the signature of all six banks, contingent upon the required approvals of the regulatory agencies. (Ex. BB) Six months later, after the last regulatory approval to construct was received, the mortgage bond was issued on Sept. 22, 1966 (Ex. 126).

(11) He personally directed every phase of the design renovation work done by the architect and the builder throughout the entire project.

(12) He also personally supervised in every phase of estimating and monitoring of construction costs.

> Note: Fahey prepared, with the builder and the architect, the first detailed estimate of total construction cost -- $530,000.00 -- confirmed by Fahey, McKinney, and Culotti by letter on 2/9/65. (Ex. IIII)
>
> The actual contract was written for $436,000.00 after McKinney demanded an attempt to make drastic cuts, which were documented by the builder as only "possible savings" (listed in Ex. LLLL dated Oct. 1965) which proved to be an unrealistic hope.
>
> The final cost was $577,300.00 which represented an increase of $47,300.00 over the original estimate, which was only 9% over the original estimate (prepared in 1965).

(Arbitration Briefs — Group C) *
Exhibit C-1 — First Final Brief on Behalf of Fahey.

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(23) He borrowed money (short term loans from Marine Midland) to overcome the shortage of working capital of the partnership.

Note:

6/14/68	$ 40,000 for 3 months
7/13/67	10,000 for 3 months
10/4/67	15,000 for 1 month
11/29/67	10,000 for 1 month
9/3/68	20,000 for 1 month
10/3/68	10,000 for 1 month
11/4/68	5,000 for 1 month
Total	$110,000

(24) He negotiated a large loan for $150,000 (on a 3-year term) from Marine Midland.

Note: The loan was granted for the stated purpose of (a) paying old bills (about $50,000) and (b) having working capital left over.

The investors withdrew $100,000 of this loan as a return of capital.

The loan was guaranteed by all 4 partners.

(25) He prepared all budgetary estimates for all revenues and expenses.

(26) He achieved the first month of full occupancy after only 10 months of operation (in March 1968 after opening the first floor in May 1967).

Note: Out of a total capacity of 135 beds, the occupancy (average daily) for March 1968 was 131.2, a rate of 97.2% occupancy.

This high rate continued (with a 50-50 ratio of private and Medicaid patients) until June 3, 1969.

From July through December, 1969 the occupancy dropped to 91.% . The loss was in private patients. McKinney restored the high occupancy in 1970 by opening the doors to Medicaid patients, so that the ratio became approximately 80% Medicaid and 20% private. (Ex. BBBB)

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(27) Fahey, by achieving rapid and balanced occupancy, confined the initial operating loss, to the year 1967, only 9 months of operation.

(28) He achieved, in the first full calendar year of operation (1968), a cash flow profit of $94,017.00 (Ex. 000).

Note: The cash flow figure must be clearly distinguished from the net income figure which is arrived at for tax purposes.

(29) He achieved, for the first 5 months of 1969, a profit level of $126,000.

Note: This amount was reduced to $108,926 by the end of 1969 because of (1) the additional administrative expenses and (2) the loss in private patient revenue, from June through December.

(30) He always maintained a completely cooperative, partnerly, and gracious open-door policy with all of his partners. They were free to come and go as they pleased, and they did.

Note: The personal correspondence over the years that was introduced into evidence shows there was never any business or social abrasiveness between the partners, even after the negotiations for transfers of interest began and were consumated.

The records and books of the partnership were always open to all partners.

He has also, of course, during this entire period, always been publicly known to be a partner; one of the principles of the business.

Fahey's management of the business as partner-administrator was highly successful. It produced:

(1) a competent, smooth-running organization;

(2) full occupancy;

(3) maximum, high-level care and services to the patients; and

(4) a high profit-level in a very short period of time.

B. Evolution of Partnership Documents Relating to Management of the Partnership

During the 4½ years that Fahey has managed the partnership, he has done so under the continuing authority of 3 partnership agreements.

Now McKinney challenges Fahey's right to continue managing the business on the ground that Article 13 gives him the right to do so.

Fahey contends that McKinney has no such right -- that Article 13 by its own self-limiting language is subordinate to (1) rules of law governing the relationship between partners and (2) other provisions of the agreement.

Fahey contends that other provisions of the agreement give him a continuing vested right to manage the partnership as a partner (not as an employee) -- a right which has existed in all the partnership agreements, in other partnership documents, and with the understanding of all partners, since the inception of the project.

a. Pre-partnership negotiations -- (Aug. 1961 - Nov. 1964)

(1) Before Fahey even began to seek equity investors, he

was already performing all the managerial functions required to set into motion all the operating elements of the entire project -- including making initial architectural revisions, estimates of construction costs, detailed operating budgets, etc., and had already obtained preliminary commitments for construction and financing.

(2) The parties from whom he obtained commitments conditioned their support on their own estimate of his technical and management expertise, and also on Fahey's assurances to them that he was developing the project in an owner-operator capacity, and would, therefore, ensure the preservation of high professional and ethical business standards.

Note: This point about Fahey's personal role as managing partner was considered to be so important to the mortgage broker (Marine Midland Mortgage Marketing), and to the 6 Syracuse banks who participated in the mortgage, that a special management provision was inserted into both the mortgage commitment letter of April 8, 1968 and in the final mortgage bond of Sept. 22, 1966, requiring prior written approval of any change in management (These requirements are covered later in detail).

(3) When Fahey first discussed the project with McKinney, Simpson, and Metzger at the Harvard Club meeting in New York on November 16, 1964, Fahey made it perfectly clear that this was his project and he would have to retain management control to make it a success for himself and simultaneously provide a

good return to the investors.

Since Fahey was the only one who knew anything about the nursing home business, this was accepted by everyone as a simple matter of business common sense.

The essence of the offer made by Fahey was that (1) Fahey was providing developmental and managerial skill; (2) the investors would provide equity money; and (3) they would split the profits 50-50.

b. Memorandum of understanding -- (Nov. 23, 1964)

(4) This basic arrangement was documented a week later, on November 24, 1964, in Syracuse where the 4 men met, formed a partnership, and drew up and signed a partnership agreement which they titled "Memorandum of Understanding." (Ex. A).

The term "managment" per se was not used in this agreement. Instead, the agreement covered voting control percentages (Item 6):

Fahey	45.0%	McKinney	42.5%
Metzger	5.0%	Simpson	7.5%
	50.0%		50.0%

Under this arrangement, Fahey had the largest voting bloc and McKinney could not control policy unless he had the votes of both minority partners to override Fahey.

However, the agreement also provided the investors with a temporary veto power to control expense during

the renovation period -- "from the conception of the project until one year after closing of the purchase of the property" -- the investors would have a 60% voting control of the project (51% to McKinney and 9% to Simpson).

After the agreement was signed, Fahey immediately proceeded with development work, with special attention to arrangements for purchasing the hospital property.

McKinney returned to New York and consulted his attorney, Bill Murray, who prepared drafts of a limited partnership agreement, concerning which he corresponded with the Syracuse firm of Gallagher and Kernan, who were acting as attorneys for the partnership.

c. Limited partnership agreement -- (Jan. 4, 1965)

(5) On January 4, 1965, the 4 partners met again in Syracuse to meet with the hospital property owners and on the same day they signed a new partnership agreement establishing a limited partnership (Ex. E).

(6) This agreement contained a specific provision on management -- Article 13 Management of the Partnership -- which provided that questions of management policy would be determined "by a majority in interest of the general partners".

There were only 2 general partners: Fahey with a 45% interest, and McKinney with a 42.5% interest -- Fahey thereby having the majority in interest of the general partners.

Metzger was listed as a limited partner but his legal status, according to the attorneys, would be that of a general partner because his capital contribution to the partnership was listed as "None". Metzger did not wish to be a general partner. Consequently, the attorneys Gallagher (for the partnership) and Murray (for McKinney) advised the partners to change Metzger's status to a limited partner by executing an amendment to the partnership agreement which changed his capital contribution from "None" to $2,000.00 (Ex. F).

Fahey, who was also listed as a limited partner with a capital contribution of "None", wished to remain a general partner, so no change was made in in his capital contribution.

Attorney Murray, who drafted the agreement, explained to Fahey that the listing of McKinney as the only general partner was to satisfy McKinney's vanity for a "title", and it had no bearing on the legal status of the partners. Fahey fully accepted this explanation since even the original title of the agreement itself had read "Articles of Partner-

ship of Walker McKinney" (Ex. B) which attorney Gallagher objected to and changed.

(7) The provisions of Article 7 -- Profits and Losses -- show Fahey's basic role as a partner managing the business rather than as an employee managing the business. (Note: This entire Article was carried over, intact into the general partnership agreement).

The very fact that paragraph 7.1, covering Fahey's salary, is treated under profits and losses, and nowhere else, reflects the understanding that his role as partner-administrator is a "constitutional" relationship with his partners rather than a subsequent "contractual" relationship of an employee with the partnership.

Nobody hired Fahey. He has no contract of employment, in the narrow sense, to act as partner-administrator. His position as administrator is built into the partnership agreement as an inherent adjunct to his position as a partner.

If Fahey were to be asked "By what right do you occupy the position of administrator and also draw a salary of $20,000 per year?" Fahey would answer, "By right of the partnership agreement itself, which can be changed only by the partners, and not by any one of them."

Note: The opposite is true of the employment of McKinney and Simpson. It was Fahey who

hired both McKinney and Simpson (Ex. II) and issued their monthly salary checks -- at the rate of $12,000 per year for McKinney and $2,400 per year for Simpson.

Even the amount of Fahey's salary was established in Article 7 and therefore it could not even be raised or lowered without the agreement of all the partners.

The actual amount of Fahey's salary is also significant because this salary ($20,000) was far lower than the partnership would have to pay to attract an experienced professional manager to administer the development and operation of a highly specialized business that would gross over $1 million per year. The present administrator at Castle Rest is being paid, for operational administration alone (of a fully established operation), a guaranteed salary of $32,500. plus many fringe benefits (Ex. GGGG). For Fahey, even this difference of$12,500 per year in salary alone already amounts to a 5-year investment of $62,500. in the business. The reason for such a salary limitation is self evident -- Fahey and all the partners expected that Fahey would receive the majority of his income benefits from the profits of the partnership, and Fahey was willing to make this investment as a partner, not as an employee.

(8) Fahey's role as managing partner-administrator is further reinforced by the provisions of paragraph 7.5 which permits Fahey to retire from his role as

administrator, remain as a partner, and continue to draw his share of profits from the business without having to do anything with respect to managing the business.

The amount he could draw without working in the business is proportionally linked to a 10-year period starting in January 1965. Thus, if he chose to end his managerial work after 5 years (January 1970), he could then continue to draw from that time on, 50% of his 45% share of profits, or 22.5% of the total share of profits. If he waited the full 10 years, he would draw his full 45% share of the profits from then on without working as managing administrator.

The choice of continuing to manage or not is entirely Fahey's. This article gives Fahey the right to develop an increasing vested interest that finally becomes toally divorced from any obligation to manage the business.

There is no restriction on this vested right to manage the business anywhere in the agreement. What this provision says, in essence, is that Fahey can manage the business as long as he wants to.

This provision underscores Fahey's contention that all the partners did understand and did agree that he would manage the business.

(9) Even though the management provisions of the agreement were clear, it was appropriate for attorney Murray to

include in the agreement a compulsory arbitration clause (Article 15) that was broad enough in scope to cover any dispute that might arise amongst the partners, including questions of management policy.

This clause gives every partner, regardless of the size of his interest in the business, equal status to have any dispute that cannot be resolved between the partners be settled on its merits by arbitration.

Thus, the arbitration clause itself limits the ultimate managerial power which may be assigned to any one partner by the language of the agreement, since by definition, any dispute arising out of the agreement is subject to arbitration rather than to the arbitrary decision by any one or more partners.

(10) After the limited partnership agreement was signed in January, 1965, Fahey continued to direct the various development phases of the project.

d. Change from limited partnership agreement to general partnership agreement -- (Nov. 16,1965)

(11) In July of 1966, the application that had been submitted to the New York State Department of Social Welfare was returned with the advice that a limited partnership to operate a nursing home was not permissable -- it would have to be a general partnership.

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(12) It was agreed by all the partners to revise the limited partnership agreement only to the extent that was necessary to satisfy the New York State requirements for a general partnership. The conditions and intents of the limited partnership would be preserved. This would be a revision of form, not a change in substance.

McKinney himself made this point very clear in a letter he sent to the partnership attorney (Gallagher) on October 19, 1965 (Ex. I), with a copy to all the partners.

(13) On November 15, 1965, the partners met in New York, at attorney Murray's office, and signed the revised agreement establishing a general partnership.

(14) The revised agreement contained one change in substance over which the partners argued before signing the agreement, the insertion of a new Article 8 allocating all the depreciation to only 2 partners -- McKinney (85%) and Simpson (15%). (In the limited partnership agreement, there was no special provision on depreciation. In fact, there was not even any Article 8 -- the numbering of the Articles skips from Article 7 to Article 9.)

McKinney and his attorney Murray finally persuaded Fahey and Metzger to accept the new Article 8 on the ground that they should yield in this matter to the desires of the investors, which they did, and

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which Fahey now insists should be enforced.

Note: The allocation of depreciation has now become the most vital and important monitary issue in this case, which drastically affects the distribution of income to the partners, and is discussed separately.

(15) The only other revisions in the limited partnership agreement were:

(1) Renaming the partnership a general rather than a limited partnership.

(2) Changing the titles of the partners from "general partner" to "senior partner", and from "limited partners" to "junior partners".

(3) Substituting "senior partner" for "majority in interest of the general partners".

(16) Attorney Murray explained to Fahey that items (2) and (3) were inserted merely to give McKinney a "title" -- that Fahey would, of course, continue to be the managing partner of the business as he was obviously so designated to be in Article 7.

Fahey accepted this explanation at its face value, as did the other partners, and they all signed the general partnership agreement, the rest of which was a repetition of all the provisions of the limited partnership agreement.

(17) Fahey, of course, continued to operate as managing partner as he developed the project -- one important phase of which related directly to his capacity as

managing partner -- securing the mortgage commitment and the mortgage bond.

e. Management stipulations of mortgage commitment letter -- (April 8, 1966) -- and the mortgage bond (Sept. 22, 1966)

(18) During the lengthy period of meetings and negotiations to satisfy the mortgage conditions and requirements of the 6 Syracuse banks (from November 1964 to April 1966), the bankers all became intimately familiar with the various aspects of the nursing home project, and especially with the relative importance of special managerial expertise required to make the project a financial success (as is the case in most specialized ventures of this magnitude).

They know, of course, that Fahey was in fact developing and managing the project as a partner, and they also knew he was the only one of the 4 partners who had the required managerial expertise upon which the banks could rely.

The banks made it very clear to the partners that Fahey's capacity as managing partner-administrator was a prime factor in the granting of the mortgage loan (See Ex. ZZZZ).

It was considered so important that it was made a security condition that was written into the mortgage commitment letter of April 8, 1966 (Ex. BB):

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"SECURITY ...

"(6) ... Any subsequent change in owner or management of this project must be approved by the participating banks."

and later into the mortgage bond of September 22, 1966, issued at the time of the real estate closing and the first loan advanced by the banks (Ex. 126):

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"...The whole of the principle sum shall, at the option of the mortgagee, become due and payable if, without the written approval of the mortgagee: ... (3) there is any change in management of the nursing home."

(19) Thus, Fahey's capacity as managing partner-administrator was contractually linked by the partnership (with the knowledge and signed consent of all partners) to the entire mortgage obligation, -- a violation of which would make the partnership immediately liable to pay the entire mortgage.

f. 'Additional management stipulation in loan agreement covering loan of $150,000 -- (April 3, 1968)

(20) After the nursing home opened in May 1967, Fahey began another longbank negotiation, this time with Marine Midland to borrow sufficient funds for adequate working capital, $150,000.00 to be repaid over a period of 3 years, in monthly installments of $4,563.30 ($54,759.60 per year).

(21) This required that Fahey demonstrate to the bank,

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in his capacity as managing partner-administrator, that the business would be able to continuously generate, in its infancy, enough profit to carry the loan.

(22) By April, 1968, Fahey convinced the bank that the business was on a sound basis, and gave the bank his own professional assurance that it would continue that way.

(23) The bank granted the loan, but again required a specific stipulation in the loan agreement making Fahey's management a condition of the loan. (Ex. NN):

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"8. During the term of this Agreement, and so long as any of the indebtedness created pursuant hereunder shall remain unpaid, the Borrower, without the prior written consent of the Bank, will not:

...(g) Make any material change in the management of the Borrower;"

(24) The loan agreement and the promissory note were signed by Fahey, and a personal guaranty of the loan was signed by all 4 partners, accepting all the terms and conditions of the loan agreement.

The 4 partners also signed a separate agreement defining the scope of their individual liability as being the same proportion set forth in Article 7.4 of the general partnership agreement. (Ex. QQQQ).

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g. Special note on bank commitments concerning Fahey's continued management

We submit that the banks would not have granted the mortgage commitment letter, the mortgage bond, or the $150,000 loan if they had heard McKinney saying then what he is arguing now, that he could take over the management anytime he wanted to and relegate Fahey to the role of employee following his orders (or even get rid of him).

McKinney, in fact, personally assured the banks that the opposite was true -- that the banks could rely on the fact that Fahey was indeed the managing partner and would control the operation of the nursing home. (Ex. ZZZZ).

We submit that these are clear contractual commitments of the partnership which McKinney cannot be permitted to abrogate.

McKinney clearly indicated in May of 1969 that he was very much aware of these contractual commitments when he held a secret meeting with the banks and tried unsuccessfully (with his attorney Murray) to convince them that he had the power to expel Fahey, and tried to obtain their written approval of a change in management, as required by all the banking agreements.

After he was refused, McKinney considered this to be so important that he went even further. He wrote a letter to the Marine Midland bank (Mr. Copeland, Vice-

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President), stating the opposite of what had really happened -- stating that the banks did approve of removing Fahey (Ex. RRRR). This prompted an immediate and strong response from Mr. Copeland denying that this had ever happened (Ex. ZZZZ).

Not to be denied, McKinney went still further. He simply ignored the position of the banks, and proceeded to obtain the ex parte injuction (with a $75,000 bond), without telling the bank he was going to do so. He thereby, in one stroke, breached (1) the contractual commitments with the banks and (2) the contractual commitment in the partnership agreement to submit all disputes to arbitration (which was not shown to the court when he obtained the temporary injunction).

Thus, just before the injuction, McKinney suddenly used words of power with the bankers, but his actions were all those of a man who knew that Fahey was the rightful manager of the partnership.

h. Special Notes on Article 13

McKinney is now attempting to deprive Fahey of his vested right to manage the partnership on the ground that Article 13 gives him the right to do so.

We submit that the self-limiting initial language of Article 13 itself defeats McKinney:

"Except as otherwise provided by law and except as otherwise provided in these Articles ..."

This language, as we have already pointed out, makes the rest of Article 13 subordinate to (1) rules of law and equity governing the relationships between partners and (2) the other provisions of the partnership agreement.

This means that Article 13 is subordinate to Article 7, which we submit gives Fahey a continuing vested right to manage the partnership business (see paragraph 'c' above).

It also means that Article 13 is subordinate to Article 15 which requires compulsory arbitration of all disputes between partners, thereby giving all partners an equal voice in all unresolved disputes.

Thus, we submit that Article 13 is completely self-limiting and does only what attorney Murray said it was intended to do -- give McKinney a "title".

> Note: Murray's explanation was understandably plausible and acceptable by Fahey at the time it was made, since it was a repetition of the explanation given when the limited partnership agreement gave McKinney the "title" of general partner.
>
> If, on the other hand, McKinney and Murray planted this as a time-bomb they could explode on Fahey later (who was then without benefit of counsel), then equity demands that McKinney should not be heard at all on this ground after he himself breached the arbitration clause of the agreement and deceived the court in obtaining the temporary injunction.

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We also submit that by virtue of the open and written agreements with the banks (by all 4 partners) regarding Fahey's continuing role as managing partner, McKinney forever foreclosed the possibility of exercising any hidden intent to use Article 13 to take over the business.

We submit that McKinney's argument is also contested by the fact that the other partners recognized and accepted that Fahey was managing the business, and that they clearly wanted him to do so, for their own benefit; and also by the fact that McKinney himself wanted and accepted this management, up until the time the business was highly profitable and became a good thing to take over.

We submit that the basic difference that arose as a "power" conflict between Fahey and McKinney, as partners, has to do with the financial relations between the partners, and not with any of the operational matters related to running the business. In other words, there were no significant or unresolved, differences that had to do with Fahey's managerial functions involved in generating a profit -- they only had to do with distributing the profit after it was generated.

Note: See the highly significant discussion of the distribution of depreciation and income.

(Arbitration Briefs — Group C) *

Exhibit C-1 — First Final Brief on Behalf of Fahey.

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but 10% of his interest to his mother or to anyone else. Also suppose that Fahey were later to acquire the other 90%. The absurdity of McKinney's position becomes obvious because of the size of the percentages used in the example, but the principle remains with respect to McKinney's present minority interest versus Fahey's majority interest.

We also submit that our interpretation of Article 13 does not deprive McKinney of any of the normal management or other rights of a minority partner having a 42.5% interest in the partnership. We simply interpret Article 13 and the entire agreement as not calling for the unwarranted deprivation of the rights of Fahey.

As a final point on Article 13, we submit that the "power" relationship between Fahey and McKinney was very clearly understood between themselves. McKinney himself put it simply by stating that Fahey always treated McKinney as an equal partner. This is absolutely accurate. Even though Fahey always had a larger interest than McKinney, and was also the managing partner, he did treat McKinney and all the partners as equals, regardless of their percentage of interest. Fahey did not consider that Article 13 created a "superior" partner in McKinney or that Fahey was in any way "subordinate" to him in the partnership. Fahey did,

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however, accord McKinney a proper deference to which an investor is entitled, even after Fahey had acquired the majority interest in the partnership.

After Fahey informed McKinney of his acquisition and of the new alignment in the partnership, Fahey made a special point of making it clear to McKinney that business would go on as usual, that there would be no change in McKinney's status, and that he, Fahey, had made this purchase simply as a matter of self-protection. McKinney conversed with Fahey about the transaction, expressing "surprise" at Simpson, but did not raise any objections on the basis of Article 13 or anything else.

What resulted instead, after McKinney left Syracuse and went to New York, was a flurry of registered letters, a belated attempt to buy out Simpson, secret meetings with attorneys and the banks in Syracuse, and finally, the ex parte injunction temporarily barring Fahey from the premises.

We submit that if these actions by McKinney are any indication at all of what management power means to McKinney, he should be denied it on equity grounds alone.

Furthermore, what is equally significant regarding management power in this case, are the internal effects of such power, which are felt not just by employees but primarily by elderly patients whose well-being is

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totally dependent upon the attitudes and practices of whoever is in control of the nursing home. We feel obligated to point out in this regard, that a significant difference has appeared between Fahey's management and McKinney's management. Fahey was able to provide maximum, high-level care and services to all patients, resulting in full occupancy at a high profit level, with a continuing 50-50 ratio between Medicaid and private patients. McKinney's management resulted in a significant drop in occupancy of private patients, and a drop in profit, which we submit is attributable in great measure to his immediate curtailment of services, and fumbling, graspy approach to increasing rates, all of which produced considerable dissatisfaction among the patients, resulting in many verbal protests and at least one letter of extremely sensitive protest from an attorney who is the nephew of a resident in the residential wing (Ex. FFFF).

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POINT IV

FAHEY'S FINANCIAL INTEREST

The most important single threat to Fahey's present and future financial interest in the partnership is that McKinney is now exploiting an accounting "oversight", and is trying to convert this oversight into a permanent device for depriving Fahey of any net income as a partner for a long time to come.

This oversight involves a key provision in the partnership agreement that drastically affects the calculation of net income to each partner.

This key provision is Article 8, which clearly and unavoidably allocates all the depreciation to McKinney (85%) and Simpson (15%), and none to Fahey and Metzger.

The "oversight" occurred in the preparation of the 1968 partnership financial statement and U.S. Partnership Tax Return, by the firm of Ernst & Ernst, who are the regular accountants for the partnership.

In calculating the net income of each partner, the accountant did not give effect to Article 8 at all.

This has the effect of calculating the net income of each partner as if the partnership were a corporation -- whereas if the calculation is made in accordance with partnership rules, the application of the depreciation percentages in Article 8 has an effect that is drastically different from the calculation for a corporation.

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Ernst & Ernst did not learn of this oversight until after the arbitration proceedings began. Accordingly, they worked with Mr. Fahey in the detailed preparation of Exhibits TTTT, UUUU, VVVV and WWWW to reflect the assumption that Article 8 must be given effect.

We, therefore, strongly submit that Fahey's exhibits which assume the full operation of Article 8 should be given effect in order to avoid the terrible injustice of having an oversight deprive Fahey of his legitimate income from the partnership. (Mr. Foody of Ernst & Ernst has verified the validity of the figures and has stated that based on the assumption that Article 8 is to be given effect, the calculations are correct.)

In the following material, we will present our facts and arguments regarding depreciation and other matters within the correct framework for calculating the net income of partners.

We also respectfully suggest to the Arbitration Board that, in construing this agreement, consideration must be given to the fact that it was drawn by Mr. Murray, personal attorney for McKinney, and therefore must be strict construed against McKinney.

A. The Basic Factors Governing the Determination of the Financial Interests of the Partners -- and Summary of the Basic Disputes

The financial interests of the partners are governed by 2 articles in the general partnership agreement (1) Article 7 on profits and losses; and (2) Article 8 on depreciation, both of which must be applied to determine the net income of each

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partner.

Note: Article 8 on depreciation did not appear in the partnership agreements until it was demanded by McKinney at the time the limited partnership agreement was revised into a general partnership agreement, to satisfy the prohibition of NY State against limited partnerships for nursing homes (see "d. Changes from limited partnership agreement to general partnership agreement -- Nov. 16, 1965" under Point III, Future Management of the Partnership).

We will treat Article 12(H) in connection with Article 7 to which it is related.

Since the net income of each partner is arrived at by first applying Article 7 and then Article 8, the answer to the question -- what is the financial interest of Fahey -- must be treated in three parts:

(1) What is Fahey's percentage interest under Article 7?

(2) What is Fahey's percentage allocation of depreciation under Article 8?

(3) What is Fahey's resulting net income (in dollars), after applying his depreciation allocation (Article 8) to his income distribution (Article 7).

Table 1 places these three questions within the context of the basic accounting framework for calculating net income. It shows the simple relationship between revenue, expense, income before depreciation, depreciation, and net income.

This table is the basic reference for all discussions about the financial interests of the parties.

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Table 1. The Basic Calculation of Net Income for the Individual Partners in a Partnership

	Partnership Total	Partners' Distribution				
		McK	Simp Fahey	Fahey	Metzger Mrs McK	
(1) REVENUE						
(2) Less EXPENSE (excluding depreciation)*						
		Article 7 Allocations				
(3) Income before depreciation		42.5%	7.5%	45%	5%	
(4) Less Depreciation Allocations		Article 8 Allocations 85%	15%	-0-	-0-	
(5) NET INCOME TO PARTNERS						

*Notes:

Under the heading "Partners Distributions", we have listed the names of all the original partners, and we have also added the names of Fahey and Mrs. McKinney under the names of Simpson and Metzger, respectively, to indicate the present ownership of those interests.

The Article 7 percentage allocations and the Article 8 percentage allocations, are in dispute for 1968 and 1969. The percentage allocations we show here are those Fahey contends should apply for both 1968 and 1969.

Expense (excluding depreciation) -- line (2) -- is in dispute for 1969 only.

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We have not entered any dollar figures on this basic table, because the most important elements of the table are the percentage allocations derived from Article 7 and Article 8. Once the percentages are established, the dollar figures follow. (We will refer to dollar figures and to the exhibits where appropriate).

We have entered on the reference table only the percentage figures which Fahey contends should apply. The income percentages from Article 7 are shown on line (3) of the table (Income before depreciation); the depreciation percentages from Article 8 are shown on line (4), (Depreciation allocations).

Fahey contends that these percentages should be used in the calculation of net income for the years 1968 and 1969.

> Note: There is no dispute over the calendar year 1967 because this was a loss year, and all the losses and all the depreciation properly went to McKinney and Simpson in the same proportion, 85% and 15%, as required by Article 7 and Article 8, respectively.

There is also a separate dispute over expenses, (line (2) of the table), for the calendar year 1969 regarding:

(1) Certain legal expenses incurred by McKinney and paid out by the partnership, which Fahey contends are not properly chargeable to the partnership, and;

(2) The outstanding amounts due for public relations expense resulting from the contract with the Jefferson-Franklin Corporation, which Fahey contends is an obligation that should be paid,

and which McKinney has refused to pay on the ground that Fahey had no power to enter into the contract.

Thus, we can summarize the areas of dispute with respect to Table 1 as follows:

(1) Revenue

No dispute.

(2) Expense (excluding depreciation)

Dispute for 1969 only.

(3) Income before depreciation (Article 7)

Dispute over allocation of percentages for 1968 and 1969.

(4) Depreciation allocations (Article 8)

Dispute over allocation of percentages for 1968 and 1969.

(5) Net income to partners

In dispute for both 1968 and 1969 -- since these figures result from the preceding ones.

B. Fahey's Allocations Under Article 7 for 1968 and 1969 (Table 1 -- Line (3) Income before depreciation)

We will discuss, in the following order:

(1) How Article 7 operates;

(2) Fahey's allocation of income before depreciation for 1968;

(3) Fahey's allocation of income before depreciation for 1969; and

(4) Fahey's interpretation of Article 12 (H).

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(1) How Article 7 operates

The allocation of income (before depreciation) in Article 7 is governed by paragraphs 7.2, 7.3, and 7.4.

These paragraphs provide for a 50-50 split (between McKinney and Simpson on the one side, and Fahey and Metzger on the other side), in conjunction with a priority of allocation to McKinney and Simpson that is tied to the fluctuating size of their capital account.

Specifically, the 3 paragraphs provide for both the fluctuating capital account and the 50-50 split under the following conditions:

(a) Condition No. 1 -- No capital account

If, for a particular year allocations are made, McKinney and Simpson have had no capital account (the capital account was "-0-"), then:

(1) Paragraphs 7.2 and 7.3 do not even operate because they come into effect only when McKinney and Simpson have had a capital account during that year, so the 50-50 allocation is governed by paragraph 7.4.

(2) Paragraph 7.4 allocates the 50-50 split as follows:

McKinney	42.5%	Fahey	45.0%
Simpson	7.5%	Metzger	5.0%
	50.0%		50.0%

(b) Condition No. 2 -- Capital account

If, for the year allocations are made, McKinney and

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Simpson have had a capital account (over "-0-" during the year), then there are 3 allocations made:

(1) Paragraph 7.2 gives McKinney and Simpson a first priority allocation equal to a 20% return on the capital account that existed during that year.

(2) Paragraph 7.3 then provides an equal amount to Fahey and Metzger (thus preserving the 50-50 split concept).

(3) Paragraph 7.4 then picks up the 50-50 concept again, by distributing the remainder:

McKinney	42.5%	Fahey	45.0%
Simpson	7.5%	Metzger	5.0%
	50.0%		50.0%

(c) Condition No. 3 -- Accumulated allocation from prior capital account

Under paragraph 7.2, McKinney and Simpson can also accumulate the 20% return on their capital account from year to year -- the return is stated as being "cumulative in nature". This appears to mean that, in any one year, the first allocation of the total income before depreciation should be the total accumulated allocation from prior years.

We will now apply these allocation rules to the conditions that existed in 1968 and 1969, to arrive at percentage and dollar allocations. (After that, we will present Fahey's version of Article 12(H).

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(2) Fahey's allocation of income before depreciation for 1968

In 1968, the total partnership income before depreciation was $119,390.51.

Note: This figure is not in dispute. See the combined Statement of Operations for 1968 in Exhibit TTTT (Fahey) and Exhibit UUUU (McKinney).

In 1968, the following conditions existed regarding the capital accounts.

(a) The capital accounts of McKinney and Simpson were reduced to "0" in April 1968.

Note: This occurred when they withdrew $100,000 from the proceeds of the loan of $150,000 from the Marine Midland bank. Their capital accounts were actually reduced to a negative balance for the rest of the year, meaning that they owed money to the partnership (over $7,000) during that time, but we will not take this into account, and will simply proceed on the condition that the capital accounts were reduced to "0".

(b) McKinney and Simpson had thus far accumulated, from year to year, an allocation on their capital account (20% on the fluctuating capital account from Jan. 1965 to April 1968) that amounted to $106,012.68:

(1)	McKinney	$90,509.97
(2)	Simpson	15,502.71
		$ 106,012.68

Under these conditions, the total income before depreciation, $119,390.51, is divided as follows:

The first portion goes to McKinney and Simpson for their cumulative income allocations from prior years--$106,012.68.

The remaining balance of the income, $13,377, is split by

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the 4 partners by the percentages of paragraph 7.4, because the capital accounts of McKinney and Simpson were now reduced to "0".

The actual dollar and percentage allocations are as follows:

	Partnership Total	Distribution to Partners			
		McKinney	Simpson	Fahey	Motzger
Allocation of cumulative	$106,012.68	$90,509.97	$15,502.71	-0-	-0-
Allocation of balance of income (Art. 7.4%)	13,377.83	42.5% 5,685.58	7.5% 1,003.84	45% 6,020.02	5% 668.89
Total allocation of income	$119,390.51	$96,195.55	$16,506.05	$6,020.02	$668.89

The bottom line would be the dollar entry for Table 1, line (3), Income before depreciation. (See the "Combined Statement of Distribution of Depreciation and Income to Partners" for 1968 in Exhibit VVVV).

(3) Fahey's allocation of income before depreciation for 1969

In 1969, the total partnership income before depreciation was $108,926.45.

Note: This figure is in dispute because of the dispute over expenses for 1969. We are assuming Fahey's figure to make the more basic point about the percentage allocations of income. For both figures, see the Combined Statement of Operations for 1969 in Ex. TTTT (Fahey) and Ex. UUUU (McKinney).

In 1969, the condition regarding the capital accounts of McKinney and Simpson was simple -- the capital accounts were at "0" all year.

> Note: Actually, they were both indebted to the partnership because of their excessive withdrawals until McKinney paid back what he owed ($7,117.93) during 1969.

Under this condition of no capital account, paragraphs 7.2 and 7.3 do not operate, and the total income before depreciation, $108,926.45, is split by the 4 partners by the percentages of paragraph 7.4.

	Partnership Total	Distribution to Partners			
		McKinney	Simpson (Fahey)	Fahey	Metzger (J. McK)
Allocation of income (by Art. 7.4%)		42.5%	7.5%	45.0%	5%
	$108,926.45	$46,303.77	$8,159.49	$49,016.92	$5,446.43

This line would be the dollar entry for Table 1, line (3), Income before depreciation. (See the "Combined Statement of Distribution of Depreciation and Income to Partners" for 1969 in Exhibit VVVV).

(4) Fahey's interpretation of Article 12(H)

We have gathered from the testimony that McKinney has a theory not clearly specified that Article 12(H) somehow operates as an "instant wipe-out" mechanism that deprives Fahey of all his interest in the partnership.

We have not yet seen, in writing, what the precise theory

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is, or how it specifically operates in conjunction with Article 7 to which Article 12(H) is directly related.

Accordingly, we are presenting the following as Fahey's interpretation of Article 12(H).

> Note: Although there are several interpretations of Article 12(H) that can be made and attacked as absurd or inconsistent with the rest of the agreement, we are confining ourselves to an interpretation that does make it operative and workable with Article 7.

Article 7 (Paragraphs 7.2, 7.3, and 7.4) is governed by two basic conditions:

(1) It does not operate until there is income to be divided, and

(2) It is linked to the fluctuating capital accounts of McKinney and Simpson.

Since Article 12(H) is linked directly to paragraph 7.4, it is governed by the same 2 conditions that govern paragraph 7.4.

Consequently, the specific governing conditions for Article 13(H) are:

(1) It does not operate until there is income to be divided, and

(2) It does not operate unless the combined fluctuating capital accounts of McKinney and Simpson maintain an average level exceeding $100,000 during the year for which income is to be distributed.

Both of these conditions must be met in order for Article 12(H) to become operative.

Under this interpretation, Article 12(H) becomes what it was intended to be--an additional return over and above the 20% already being earned as a first priority distribution, not only annually, but cumulatively, on the capital accounts of McKinney

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and Simpson, by virtue of the provisions of paragraph 7.2.

The conditions for activating Article 12(H) have never occurred, and the likelihood of them occurring in the future is small, since McKinney and Simpson reduced their capital accounts to "0" in 1968 and they have remained there ever since.

C. Fahey's Allocations Under Article 8 for 1968 and 1969 (Table 1--Line (4) Depreciation Allocations)

We will discuss, in the following order:

(1) How Article 8 operates

(2) Fahey's allocations of depreciation for 1968 and 1969

(1) How Article 8 operates

Article 8 clearly and unavoidably allocates all the depreciation to McKinney (85%) and to Simpson (15%), and none to Fahey and Metzger.

The dollar figures for each partner are arrived at by simply multiplying the total depreciation figure for the year by the percentage allocated to each partner.

What is vitally important about this dollar figure for each partner is that this figure represents his own "personal" as distinguished from "partnership" expense allocation. (It corresponds to his own "personal" portion of income before depreciation).

He would enter his depreciation on line (4) of the reference Table 1.

He would then subtract the depreciation from the income before depreciation, thereby arriving at a final Net Income figure for himself.

The Net Income will show a Loss if the amount of the depreciation is larger than the amount of income before depreciation. This loss can then be used by the individual partner as a tax loss shelter for income derived from another source.

(2) Fahey's allocations of depreciation for 1968 and 1969

The total depreciation figures for 1968 and 1969 are not in dispute. (See the Combined Statement of Operations in Exhibit TTTT (Fahey) and Exhibit UUUU (McKinney).

The total depreciation for 1968 is $109,169.16 and the total depreciation for 1969 is $100,485.27. We then apply to these amounts the depreciation percentages allocated to each partner, giving us the following dollar figures:

		1968	1969
McKinney	-- 85%	$ 92,793.79	$ 85,412.48
Simpson	-- 15%	16,375.37	15,072.79
Fahey	-- -0-	-0-	-0-
Metzger	-- -0-	-0-	-0-
		$109,169.16	$100,485.27

These would be the dollar entries on line (4) of Table 1. (See the "Combined Statement of Distribution of Depreciation and Income to Partners" for 1968 and 1969 in Exhibit VVVV).

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D. Fahey's Net Income for 1968 and 1969
(Table 1, line (5), Net income to partners)

We have now developed the entries for lines (3) and (4) of Table 1, and all that remains is to subtract the amounts on line (4) from line (3) to arrive at net income, line (5).

We will now carry the process an additional step further and present a completed Table 1 for both 1968 and 1969, which we will label Table 2 (1968) and Table 3 (1969).

In these tables we show the specific allocations for each partner. The partnership totals are taken from the Combined Statement of Operations in Exhibit TTTT. The Article 7 and Article 8 allocations were taken from the Combined Statement of Distribution of Depreciation and Income for 1968 and for 1969 in Exhibit VVVV, and they were also developed in the prior paragraphs in this brief.

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Table 2. The Basic Calculation of Net Income To Individual Partners -- 1968

	Partnership Total[a]	Distribution to Partners: McKinney	Simpson (Fahey)	Fahey	Metzger (Mrs. McK)
(1) REVENUE[b]	$1,133,385.60				
(2) Less EXPENSE[c] (excluding depreciation)	1,013,995.09				
(3) Income before depreciation	$ 119,390.51	(Article 7 Allocations)[d] 42.5% $96,195.55	7.5% $16,506.05	45% $6,020.02	5% $668.89
(4) Less Depreciation allocations	$ 109,169.16	(Article 8 Allocations) 85% $92,793.79	15% $16,375.37	-0-	-0-
(5) Net Income to Partners	$ 10,221.35	$ 3,401.76	$ 130.68	$ 6,020.02	$668.89

(a) All total figures are from the Combined Statement of Operations in Exhibit TTTT.

(b) "Operating revenues" plus "other income"

(c) "Total expenses" plus "interest expenses"

(d) These percentages were applied to the balance of income after first allocating all the cumulative income to McKinney and Simpson (See Ex. VVVV).

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Table 3. The Basic Calculation of Net Income to Individual Partners -- 1969

	Partnership Total[a]	Distribution to Partners: McKinney	Simpson (Fahey)	Fahey	Metzger (Mrs McK)
(1) REVENUE[b]	$1,294,259.05				
(2) Less EXPENSE[c] (excluding depreciation)	1,185,332.60				
(3) Income before depreciation	108,926.45	$46,303.77 (42.5%)	$8,159.49 (7.5%)	$49,016.92 (45%)	$5,446.33 (5%)
			(Article 7 Allocations)		
(4) Less Depreciation allocations	100,485.27	85,412.48 (85%)	(15,072.79) (15%)	-0-	-0-
			(Article 8 Allocations)		
5) Net Income to Partners	$ 8,441.18	(39,108.71)	(6,913.30)	49,016.92	5,446.33

(a) All "total" figures are from the Combined Statement of Operations in Exhibit TTTT.

(b) "Operating revenues" plus "other income"

(c) "Total expenses" plus "interest expense"

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In 1968, the Article 7 allocations include 2 distributions (already discussed): (1) all the accumulated 20% return from the capital accounts of McKinney and Simpson, and (2) the balance of the income distributed in accordance with the percentages of paragraph 7.b (because the capital accounts had been reduced to "0".)

The net income to each partner is obtained by subtracting his depreciation from the Article 7 allocations (Income before depreciation).

In 1968, the net income for each partner is a "plus" value. In 1969, McKinney and Simpson both have "minus" values (losses), because their depreciation expense is greater than their distribution under Article 7.

Each partner's share of net income for both years is summarized and totalled in Table 4.

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Table 4. Summary of Partner's Share of Net Income for 1968 and 1969

Original Partners	1968	1969
Fahey	$ 6,020.02	$ 49,016.92
Simpson	130.68	(6,913.30)
W. McKinney	3,401.76	(39,108.71)
Metzger	668.89	5,446.33
Total	$ 10,221.39	$ 8,441.18

Present Partners	1968	1969	Total
Fahey (includes Simpson)	$ 6,150.70	$42,103.62	$ 48,254.32
W. McKinney	3,401.76	(39,108.71)	(35,706.95)
J. McKinney (replaces Metzger)	668.89	5,446.33	6,115.22
Total	$ 10,221.35	$ 8,441.24	$ 18,662.59

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E. Partnership Expense for 1969
(Table 1--line (2) expenses (without depreciation)

The figure for total partnership expense for the calendar year 1969 is in dispute because of the controversy over:

(1) Legal and investigatory expenses incurred by McKinney and paid by Castle Rest -- which Fahey contends are not properly chargeable to the partnership.

(2) The outstanding unpaid balance due for public relations expense resulting from the contract with the Jefferson-Franklin Corporation -- which McKinney has refused to pay on the ground that Fahey had no power to enter into the contract.

(1) Legal and investigatory expenses

The legal and investigatory expenses were incurred by McKinney before and after June 3, 1969, and consist of three distinct portions.

The first portion was incurred before June 3, 1969 while McKinney was laying the groundwork, without Fahey's knowledge, to obtain the ex parte order. The total of this portion is $9,914.39, of which $7,520.00 was for his personal attorney, Murray (Exs. KKK and YYY), and the balance for a private detective agency, personal clerical help, and the injunction bond.

Bills for these expenses were presented for payment by Castle Rest after McKinney entered the premises, and the bills

were paid in 1969.

The second and third portions consist of expenses incurred after June 3, 1969.

The second portion was for the services of McKinney's personal attorney, Murray, and was billed by his firm Goldstein, Gurfein, Shames & Hyde, covering the period from June 4, 1969 to December 31, 1969. The amount of the billing was $10,609.77, which was not paid in 1969.

The third portion was for the services of a Syracuse law firm engaged by McKinney to pursue the controversy in Syracuse, Hancock, Ryan, Shove & Hust, covering the period from June 13, 1969 to November 30, 1969. The amount of the billing was $9,956.14 which was not paid in 1969.

The total of the second and third portions is $20,565.91 of which McKinney claims $9,000 is chargeable to the partnership.

The total claim of McKinney is therefore:

1st portion	$9,914.39	(charged as paid expense)
2nd & 3rd portions	9,000.00	(charged to accounts payable)
	$18,914.39	

Fahey contends that none of these expenses are properly chargeable to the partnership. He has entered them on his exhibits as follows:

1st portion	$ 9,914.39	(withdrawal from capital account)
2nd & 3rd portions	9,000.00	(not recognized)
	$18,914.39	

(Arbitration Briefs — Group C) *
Exhibit C-1 — First Final Brief on Behalf of Fahey.

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commission without even so much as an explanation to Fahey, even though the obligation to enter the money into the partnership had been documented in the original memorandum of understanding on November 23, 1964.

There is also the matter of the amount of Fahey's salary ($20,000) which we have already pointed out represents a salary investment for Fahey of at least $12,500 per year, amounting to a 5-year investment of $62,500.

There is also a substantial investment reflected in the $150,000 loan from Marine Midland, which is being paid back out of profits and was guaranteed by Fahey to the then extent of his interest under paragraph 7.4 -- 45% -- which represents an out-of-profits investment of $67,500, an investment which thereby did not have to come from McKinney or anyone else.

Finally, consider the substantial amount which he has invested to purchase Simpson's interest, $48,750 to protect himself, at a time when it ordinarily would have been anticipated that the partners would all be very happy with each other in the expectation of sharing in a highly profitable and worthwhile enterprise.

We suggest that these four items add up to a sizeable sum:

Real Estate Commission (7% of $350,000)	. . . .	$ 24,500
Salary Investment ($12,500 for 5 yrs)	. . . .	62,500
Bank loan (45% of $150,000)	. . . .	67,500
Simpson's interest (7.5% at $6,500 per pt)	. . . .	48,750
		$203,250

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We suggest that this total is not just bookkeeping money -- it is all very real. The real estate commission did materialize. Fahey did give up cash salary that otherwise would have been in his pocket. The bank loan does come out of actual money earned, and the purchase of Simpson's interest will also have to come from money earned.

We are simply saying, as we did at the outset of this brief, that who did what, and who is paying for what, should be put in its proper perspective.

We respectfully submit that it is equitable to take into account in this case, not only the expertise with which Fahey created, developed, and managed this business into a financial success, but also that he has contributed what the bankers would call considerable "blood money" to make the project a continuing success.

POINT V

RELIEF REQUESTED

It is respectfully requested that this Board of Arbitrators order, decree and grant the following relief:

(1) Declaration that Thomas Fahey is not expelled from the partnership either under Article 11 or 12 of the partnership agreement and that Walker McKinney's efforts either by court action, notice or otherwise to achieve such a result, are invalid and void.

(2) Declaration that Thomas Fahey acted properly within his role as partner-administrator in his actions prior to June 3, 1969 and that he shall resume his role as partner-administrator with the same management powers and duties he exercised during the period prior to June3, 1969, and shall perform the same functions he performed during the period before June 3, 1969.

(3) Declaration that Walker McKinney shall have complete access to all the books and records of the partnership and shall be afforded all rights generally afforded to a partner including but not limited to receipt of regular monthly reports of all significant operations of the business.

(4) Declaration that any future distribution of net income be made in accordance with the interest of each of the partners as herein decided.

(5) Declaration that all loans, withdrawals or additions

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to capital be jointly agreed upon by Fahey and McKinney and in the event such agreement cannot be reached, the dispute shall be referred to arbitration as provided for under Article 15 of the partnership agreement.

(6) Declaration that the purchase by Fahey of Dr. Simpson's interest in the partnership was a good and valid transfer and that Fahey now possesses all rights, title and interest formerly owned by Dr. Simpson.

(7) Declaration that the present interests of the partnership be as follows:

(a)	Mr. Thomas Fahey	-- 52.5%
(b)	Mr. Walker McKinney	-- 42.5%
(c)	Mrs. Jane McKinney	-- 5.0%
		100. %

(8) Declaration that the partners are entitled to the following amounts as their share of net income to date:

		1968	1969	Total
(a)	Fahey	$ 6,150.70	$42,103.62	$48,254.32
(b)	McKinney	3,401.76	(39,108.71)	(35,706.95)
(c)	Mrs.McKinney	668.89	5,446.33	6,115.22
	Totals	$10,221.35	$ 8,441.24	$18,662.59

(Arbitration Briefs — Group C) *
Exhibit C-2 — Reply Brief on Behalf of Fahey.

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ARBITRATION TRIBUNALS OF THE
AMERICAN ARBITRATION ASSOCIATION

In the Matter of the Arbitration

of

THOMAS M. FAHEY

-and-

WALKER McKINNEY

and

CASTLE REST NURSING HOME

and

GEORGE A. SIMPSON

Case Number: 15 10 0032 69

REPLY BRIEF ON BEHALF OF THOMAS M. FAHEY

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(Arbitration Briefs — Group C) *
Exhibit C-2 — Reply Brief on Behalf of Fahey. C-2/4 1.

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REPLY BRIEF ON BEHALF OF THOMAS M. FAHEY

The purpose of this reply memorandum is not to attack line-by-line each of the many misstatements, innuendoes, invalid assumptions, and erroneous conclusions contained in the lengthy brief submitted on behalf of Walker McKinney. To do so would only prolong this already lengthy proceeding. Mr. Fahey is willing to stand on the statement of facts contained in his original brief and accept the arbitrators' recollection and determination as to what the true facts are.

Several legal points and arguments raised by McKinney do, however, require commenting upon. McKinney's brief, it is noted, fails to cite any controlling court decisions directly applicable to the present case but rather cites a number of cases each for a broad legal principle. We have no quarrel with most of the cases cited. Exception is taken, however, to some of the conclusions drawn therefrom. McKinney argues that the agreement controls -- we agree; but what he fails to admit is that there are inconsistencies and ambiguous provisions in the agreement itself which require interpretation by this Board. It is not enough as contended by McKinney to take one isolated sentence or paragraph and ignore the rest of the entire agreement.

McKinney seems to argue that unless this Board interprets the agreement to conform to McKinney's contentions, then this Board is exceeding its jurisdictional powers and is subject to reversal in a court of law. Such clearly is not the law.

From the cases previously cited in Fahey's original memorandum, it has been clearly shown that it is for the Board of Arbitrators to interpret the agreement and resolve any ambiguities that may be contained therein. The recent case of Matter of Granite Worsted Mills, 25 NY 2d 451 relied upon by McKinney upholds this principal and even goes further to state that even in the face of an express prohibition, an arbitrator may hold contrary to said prohibition if he states his reasons for doing so, e.g. a finding that the provision is unreasonable.

The first argument raised in McKinney's brief that requires further comment is that of the applicability of Article 12(H). McKinney seizes upon the wording of Article 12(H) and by isolating the same and applying a literal reading to it, McKinney maintains that Fahey forever lost all interest in the partnership when McKinney put in capital of $225,000.00 over and above the $100,000.00 recited in Schedule A of the Agreement. If one were to read no other provision of the Agreement than Article 12(H), one would be inclined to accept McKinney's claims in this regard. But when the Agreement is read as a whole, it is clearly shown that Article 12(H) has no applicability to the present situation whatsoever. First, by reason of said clause's location in the Agreement, it is shown that it was never intended to be employed in a circumstance such as is now present, unless this Board finds that Fahey was properly expelled under Article 12. Article 12, by its very title

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"Purchase of Interest of Junior Partners", and subsequent wording, is shown to apply only to buy-out situations. The entire Article deals with the method of evaluating a junior partner's interest in current profits in the event he wishes to voluntarily withdraw or is expelled. The heading reads as follows:

> "In the event that (1) a junior partner wishes to terminate his interest in the partnership or in the event that (2) the senior partner decides that it is in the best interest of the partnership for a junior partner to withdraw, then the following procedure shall occur: (Emphasis added)
>
> (a) ...
>
> (b) ...
>
> (h) ..."

Absent said withdrawal or expulsion of Mr. Fahey, said Article should have no applicability whatsoever in determining Fahey's present interest in the partnership.

Article 12(H) by its very wording limits the amount of current profits Fahey is entitled to in computing his buy-out interest. Beyond this, said Article has no relevancy. If this were not meant to be so, then it would have been written as a separate article or have been placed in Article 7.

There is further proof that the parties never intended Article 12(H) to operate as a wipe-out of Fahey's interest. Article 7.5 provides for a vesting in Fahey of a 4.5% interest

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for each year he remains as administrator.[1] If one where to accept McKinney's claim of a 12(H) wipe-out, then there could never be any vesting as Fahey never had any interest to vest. If this were so, then there would be no reason to have included Article 7.5 in the Agreement. Such obviously was never intended because as will be pointed out later, the parties knew at the time the partnership agreement was entered into that McKinney would be investing much more than the $100,000 set forth in Schedule A.

The only reasonable interpretation that can be given to Article 12(H) is that it is only applicable if it is decided Fahey is expelled under Article 12. Then in such circumstance, it is proper in computing his interest to consider Article 12(H).

Even if Article 12(H) were intended to affect Article 7.4 in instances outside of the scope of Article 12, it could never be applied as advocated by McKinney but rather to have any meaning whatsoever, would have to be applied in a "barometric"

Fn. 1. Fahey has served 5 years as administrator and, therefore, under Article 7.5, has a vested interest of 22.225%. McKinney's attempt to limit this by saying that Fahey acted as administrator only 2 years (May, 1967 - June, 1969) is almost comical when one considers all the work performed by Fahey to get the nursing home into operation and that he was paid as administrator for this entire period. Most of all, however, the Agreement itself specifically states that said period shall run from 1/1/65 and continue to 12/31/74.

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manner depending upon the amount of the capital account from time to time. The following positively exposes the fallacy of McKinney's contention that Article 12(H) operates as a wipe-out of Fahey's interest.

POINT I.

DETAILED ANALYSIS OF THE OPERATION OF THE 7.2 - 7.3 - 7.4 FORMULA AND ITS RELATIONSHIP TO ARTICLE 12(H) AND TO THE CAPITAL CONTRIBUTIONS (DEPOSITS) OF McKINNEY AND SIMPSON

A. McKINNEY'S CONTENTIONS REGARDING HIS "WIPE-OUT" THEORY.

B. CAPITAL CONTRIBUTIONS (DEPOSITS) ARE ALREADY INCLUDED AS PART OF THE CAPITAL ACCOUNT BALANCES IN THE 7.2-7.3-7.4 INCOME-SHARING FORMULA.

C. DETAILED OPERATION OF THE 7.2-7.3-7.4 FORMULA IN RELATION TO THE CAPITAL ACCOUNT BALANCES.

D. IF ARTICLE 12(H) IS TO BE APPLIED TO THE FORMULA AT ALL, IT MUST BE APPLIED TO THE "CAPITAL ACCOUNT" BALANCE AND NOT TO "CAPITAL CONTRIBUTIONS".

E. THE ROLE OF McKINNEY'S "CONTRIBUTIONS" THUS FAR HAS BEEN LIMITED TO ACCUMULATING A 20% "INTEREST" WITHIN HIS CAPITAL ACCOUNT, AND HAS HAD NO EFFECT ON THE INCOME-SHARING FORMULA.

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A. McKINNEY'S CONTENTIONS REGARDING HIS "WIPE-OUT" THEORY

McKinney's argument that Fahey no longer has any interest whatsoever in the partnership is a mathematical and logical absurdity -- a kind of semantic slight-of-hand and a quick-disappearing act which common sense alone reveals as an obvious absurdity in its result, but which must be examined in detail to identify the absurdity or fallacy in the method.

McKinney's contention that Fahey has been completely wiped out of the income-sharing provisions of Article 7 consists of a two-stage argument:

(a) Stage 1 -- Fahey benefits under Article 7.4 were wiped out when the combined capital contributions of McKinney and Simpson reached $325,000 -- by virtue of the provisions of Article 12(H).

(b) Stage 2 -- Later, Fahey's benefits under Article 7.2 and 7.3 were also wiped out when the capital accounts of McKinney and Simpson were reduced to "0".

The obvious absurdity of this two-stage argument, in general terms, is that McKinney claims the Agreement permits him to wipe out one portion of Fahey's interest by putting money into the business, and then also permits him to later wipe out the other portion of Fahey's interest by taking money out of the business.

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This is a fantastic contention, and we submit, of course, that Article 7 permits no such thing.

B. CAPITAL CONTRIBUTIONS (DEPOSITS) ARE ALREADY INCLUDED AS PART OF THE CAPITAL ACCOUNT BALANCES IN THE 7.2 - 7.3 - 7.4 INCOME-SHARING FORMULA

Let us look at Article 7 in relation to McKinney's "Stage 1" argument -- that the capital contributions of McKinney and Simpson wiped out Fahey's benefits under 7.4.

The basic fallacy in McKinney's argument is that the income-sharing formula of Article 7 specifically operates in connection with the capital account balances of McKinney and Simpson, and not with their capital contributions.

The distinction between these terms is highly significant because one term includes the other -- that is, the capital account balance already includes capital contributions.

A partner's capital account balance is just like a bank account balance -- the balance of the account continually fluctuates with the changes made in the account. It rises with deposits and other credits, and it falls with withdrawals and other debits. The significant accounting characteristic of the capital account is the changing level of the balance of the account, not the elements which cause the balance to fluctuate.

The term capital contributions refers to one of the elements that causes the capital account balance to fluctuate-- namely the "deposits".

Note: The "capital contributions" to a partnership may take many forms -- cash, property, labor, etc. -- consequently, the term does not have a precise accounting definition, whereas capital account has an exact accounting meaning and usage, whereby capital contributions (whatever their form) are defined as being one of the elements that create the capital account balances.

Whenever "deposits" (capital contributions) are made by an individual partner, they are automatically credited to and become an inherent part of his capital account balance.

This balance continuously earns for McKinney and Simpson a 20% "interest" under Article 7.2 (as if it were a bank account balance), and this "interest" later becomes a priority distribution of income whenever income becomes available for allocation to the partners.

Thus, by having been already included in their capital account balances, all the "deposits" (capital contributions) of McKinney and Simpson have already been provided for and factored into the income-sharing formula of 7.2-7.3-7.4.

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C. DETAILED OPERATION OF THE 7.2-7.3-7.4 FORMULA IN RELATION TO THE CAPITAL ACCOUNT BALANCES

Now that we have established that the income-sharing formula is based on fluctuating capital account balances which already include "deposits" (capital contributions), let us examine in detail exactly how the formula works -- before we attack another basic fallacy in McKinney's "wipe-out" argument -- the assumption that Article 7.4 can be permanently "wiped out".

To begin with, the three paragraphs in the 7.2-7.3-7.4 formula are not mutually exclusive of each other. They define a single formula, even though it took three paragraphs to state it. No one of these paragraphs is severable from the other. The three together define a division of income under any given level of the capital account balance. Whatever the specific level of the capital account balance may be in a given income year automatically determines the specific divisions of income in that year.

We show these divisions of income at various levels of the combined capital account balances of McKinney and Simpson in Table A-1. (We have prepared this kind of table because we think it is important to see the projections of the formula in actual numbers in order to clearly identify the fallacy in McKinney's argument).

Each of the levels we have shown in the table represents an average level of capital account balance that could exist in any one year. (We have assumed the total income to be a constant of $100,000 for the sake of simplicity).

The entire table, as an entity, shows how the 7.2-7.3-7.4 formula works in combining its dual functions of providing:

(1) A 50-50 split between McKinney and Simpson on the one side, and Fahey and Metzger on the other.

(2) A changing priority of distribution to McKinney and Simpson related to the "interest" earned by the changing levels of their capital account balances -- a priority which is activated by Article 7.2 only when the level of the balance is over "0", and conversely is not activated at all when the level of the balance is at "0" in any given year.

At each level within the table, we see the single formula relationship of the individual elements of the 7.2-7.3-7.4 formula.

The "7.2" column shows the precise effect of the specific role played by the capital account balance -- to provide McKinney and Simpson with the equivalent of "interest" in a bank account (20% on their capital account balance "as it may

exist from time to time ...") which they are entitled to receive first, as a priority distribution (Article 7.2).

The "7.3" column shows the preservation of the 50-50 split principle after the priority distribution of "interest" of 7.2, by allocating to Fahey and McKinney an equal amount, to the extent that it exists in the total income (Article 7.3).

The "7.4" column shows the 50-50 split appearing under two basic circumstances:

(1) when there is a remainder after any priority distributions under 7.2 and 7.3; and,

(2) when there is no priority distribution at all, i.e., when the capital accounts are "0" (Article 7.4).

The table shows very clearly that whenever the level is at "0", McKinney and Simpson have not earned any "interest", and are therefore not entitled to a single penny of priority distribution for that year.

Looking at the entire range of capital account levels (from "0" to $400,000 and back to "0"), we see how McKinney and Simpson benefit from an increase in the levels of the capital account balances. As the levels increase, they also cause the priority distribution of 7.2 to increase, while the remaining allocations to 7.3 and 7.4 decrease, until they reach the point (at $400,000) where McKinney and Simpson are receiving 80% of the distribution (from 7.2) leaving only 20%

for Fahey and Metzger (from 713), with no remainder at all to divide under 7.4.

Conversely, we see how Fahey and Metzger benefit from a decrease in the levels. As the levels decrease, they also cause the priority of distribution of 7.2 to decrease, while the remaining allocations to 7.3 and 7.4 gradually become larger, until the levels reach "0" where there is no priority distribution under 7.2 or 7.3 and the entire income is divided 50-50 under 7.4.

Thus, what we have here is a simple "barometric" formula whereby the priority distribution of "interest" to McKinney and Simpson rises and falls in direct relation to the rise and fall of their capital account balances.

The simple economic purpose of this formula is to "guarantee" McKinney and Simpson a 20% return or "interest" on their balance as a qualifying condition to the 50-50 split between the partners.

This "guarantee" of 20% "interest" provides McKinney and Simpson with several basic economic "advantages" which are fundamentally related to the permanence and continuity of the formula itself. (These advantages stem from Article 7.2 itself, without regard to any claims made about the effect of Article 12(H) on Article 7.4). The basic economic situations wherein the priority distribution of "interest" would give McKinney and Simpson most if not all of the total income when they have a

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sizeable level of capital account balance includes:

(1) Whenever there is a "bad" year of low total income;

(2) If the rise in total income were slow and gradual;

(3) If Fahey continuously could not produce the high income level he anticipated;

(4) Whenever a "loss" year occurred -- in which case the entire 20% "interest" would be carried over cumulatively to another year.

Thus, the entire 7.2-7.3-7.4 formula works prospectively as a permanent entity that operates, by its own definition, continuously from year to year in order to provide for the two changing variables that affect the distribution of income to the individual partners:

(1) The changing levels of the capital account balances;

(2) The change in total income to be divided.

These two factors can activate the entire formula each year, and there is absolutely nothing in the language of the formula to even suggest anything to the contrary.

D. IF ARTICLE 12(H) IS TO BE APPLIED TO THE 7.2-7.3-7.4 FORMULA AT ALL, IT MUST BE APPLIED TO THE "CAPITAL ACCOUNT" BALANCE AND NOT TO "CAPITAL CONTRIBUTIONS"

We have established that the 7.2-7.3-7.4 formula operates in "barometric" response to the changing levels of the capital account balances, and that these balances already include all the deposits (capital contributions) made by McKinney and Simpson.

It is, therefore, patently absurd for McKinney to argue that Article 12(H) requires that the contributions (or "deposits") which have already been taken into consideration once in the 7.2-7.3-7.4 formula, should be taken into account twice as a device for wiping out the entire formula.

According to McKinney's theory, all he would have to do is keep making deposits that would ultimately add up to $325,000 and also make withdrawals that kept his capital account balance at "0" and Fahey would be wiped out -- which not only is absurd, but also contrary to the provisions of the 7.2-7.3-7.4 formula.

If Article 12(H) is to make any sense at all with respect to the 7.2-7.3-7.4 formula, it must be construed to apply to the "capital account" balance and not to deposits (capital contributions).

In that event, if Article 12(H) is to apply to the 7.2-7.3-7.4 formula, it must also operate within the constraints of that formula to achieve what is clearly indicated by the

"barometric" nature of that formula -- namely to give McKinney and Simpson an additional return under 7.4 (over and above his priority distribution of 20% "interest" under 7.2) -- provided their capital account balance was over $100,000 in a year when there was income to be divided.

We have shown an example of such a case in Table A-1 at a level of $200,000 in the capital account, showing McKinney and Simpson receiving 70% instead of 50% of the allocation under 7.4.

The levels at which Article 12(H) can operate are limited by its own language to levels over $100,000. It can never operate, as McKinney wants it to, at lower levels, and therefore, can never operate to permanently "wipe out" Article 7.4.

Since it does not operate at levels under $100,000, it has absolutely no effect on 7.4 when the capital account level is at "0". At that level, the percentages of 7.4 apply fully to the divisions of income to the partners.

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E. THE ROLE OF McKINNEY'S "CONTRIBUTIONS" THUS FAR HAS BEEN LIMITED TO ACCUMULATING A 20% "INTEREST" WITHIN HIS CAPITAL ACCOUNT AND HAS HAD NO EFFECT ON THE INCOME-SHARING FORMULA.

The 7.2-7.3-7.4 formula does not divide and distribute income until there is income available upon which the formula can operate.

What it does do before that during initial loss years, is build up a cumulative "interest" for McKinney and Simpson under 7.2.

This "interest" becomes only a first charge on the distribution of the total income available. It does not affect the percentage distributions on the remainder of the total income after the cumulative "interest" has been distributed.

Thus, no matter how much McKinney and Simpson deposited during the loss years, or any other year, the single exclusive effect of those funds would be to earn "interest" under 7.2, as part of the capital account, not to change the income-sharing formula itself.

In Table A-2, we show how this "interest" has been accumulated and how it should be applied. The table is a summary of the annual allocations of income before depreciation under the 7.2-7.3-7.4 formula for the years 1965 through 1969.

The table shows that from 1965 until April of 1968, McKinney and Simpson earned a cumulative "interest" of

$106,000 which was applied as the first charge on the total income for 1968 of $120,000. The remainder of the income, $14,000, was then divided in accordance with the percentages of 7.4, since the level of the capital account balance was at "0" (after McKinney and Simpson had withdrawn $100,000 in April of 1968).

In 1969, there was no "interest" earned because the capital account balance remained at "0" for the entire year. Therefore, Articles 7.2 and 7.3 were not activated and the total income for the year was distributed in accordance with the percentages of 7.4.

Thus, all of the "interest" earned by the deposits of McKinney and Simpson within their capital accounts has been accumulated and allocated, and there is no basis for considering Article 12(H) to have ever operated on the income-sharing formula.

The second point raised by McKinney that requires comment is his attempt to cast himself in the role of a financial lamb that was misled from the beginning of the partnership as to the extent of financial contribution that was to be required of him. McKinney in his memorandum repeatedly asserts that it was the original plan that the $100,000 investment was all that was going to be required and that he would get that back in one year plus a 20% return, but because of Fahey's alleged failure and faults, he was required to put up additional monies and that he did so as some sort of

favor or kind samaritan to save the entire operation. The following clearly refutes this claim.

POINT
II.

McKINNEY WAS ALWAYS FULLY AWARE OF THE TOTAL INVESTMENT PICTURE AT EVERY STAGE IN THE DEVELOPMENT OF THE PROJECT.

Throughout his testimony, McKinney made completely unsupported statements that he was a helpless, uninformed investor at the mercy of a spendthrift developer who had no control over skyrocketing construction costs, and who kept him from knowing what was going on in the business after it opened. He used the old technique of repeating these statements many time, over and over again, so they could acquire some actual form by virtue of their mere repetition.

Of course, anyone who heard the entirety of McKinney's testimony, and observed the manner in which he testified, and observed the exquisite detail of his expense account sheets and his letters that are in evidence, could hardly escape the conclusion that here was a man who would not let one nickel go by him without knowing about it, and without knowing exactly what it was for.

The facts i this case would unquestionably support such a conclusion.

First, let us consider some of the "minor" items.

Here was a man "aware" enough to:

1. Purchase property in his own name next to the nursing home -- renovate it with partnership funds (later charged to his capital account) -- rent one portion of the property to the director of nursing and have the nursing home pay him personally for her rent -- and rent the other portion to his brother who works at the nursing home.
2. Set up a leasing company in his mother's and brother's name and use it to rent equipment to the nursing home -- and then have Fahey manage the incoming and outgoing funds of the leasing company without charge.
3. Make personal visits to the nursing home at least once a month (for 1 to 3 days) -- examine all the books, talk to Fahey, and look over the project -- and exchange phone calls and letters with Fahey.
4. Engage his own construction consultant to watch over the design and construction aspects of the project -- and pay for it with partnership funds.
5. Examine all architectural and construction plans and estimates with Fahey, the architect, and the builder, and make frequent trips to monitor the actual construction.

6. Have the real estate commission (t t was supposed to go to the partnership) transferred from the Gallagher firm in Syracuse to Murray in New York -- and then use it to pay his personal legal expenses with Murray.
7. Refuse to pay any of the taxes on the hospital property they were allowed to use maintenance-free for 2 years.
8. Confer with brokerage houses in New York (with Fahey along) to investigate floating issues of nursing home stock, or disposing of the property to a chain at an inflated value.

These few items alone hardly give the impression of a "sheep" investor.

Now let us look at the major point to which he related the statement that he "didn't know what was going on" -- namely the amount of the investment.

We submit that McKinney knew exactly what the total cost was going to be, and what financing would be available -- long before the property was purchased and long before a contract was signed to raise a single hammer in the construction -- and there was absolutely no "skyrocketing" of construction costs, which were held to only 9% above the original detailed estimates made in February of 1965 -- as the facts clearly show.

The total investment was determined by the following three factors:

(1) The size of the mortgage;

(2) The amount of the mortgage available to purchase the property; and

(3) The cost of construction.

What changed in the early stages of the project were items (1) and (2). Item (3) finally turned out to be only 9% higher than the original detailed estimate, made 2 years before construction started.

Item (1) was changed by McKinney himself who lowered the mortgage condition to the hospital from $900,000 to $750,000. This happened as early as 1/15/65. (Ex. PPPP).

Item (2) was changed by the banks from the expected $250,000 down to only $100,000. This happened a year later (discussed in detail in Exs. W and X).

Let us now look at how these changes related to the "awareness" on everyone's part about the total investment cost as each change occurred.

First, let us look at the situation at the start of the partnership, and then see the drastic effect of the change in Item (1) -- McKinney's lowering of the mortgage condition to the hospital owners.

At the start of the partnership (Nov 1964)

At this point, the mortgage "commitment" was $900,000. The property cost was $350,000.

(1)	+ $ 900,000	total mortgage
(2)	- 250,000	expected bank advance for the property (plus $100,000 from investors)
(3)	- 530,000	construction (Ex. IIII)
	+ $ 120,000	available after construction (less working capital required)

After the mortgage was lowered (Jan 1965)

When McKinney dropped the mortgage contingency to the owners (to induce them to sign a purchase offer), the breakdown was then:

(1)	+ $ 750,000	total mortgage
(2)	- 250,000	expected bank advance for the property (plus $100,000 from investors)
(3)	- 530,000	construction
	(- $ 30,000)	available after construction (less working capital required)

So as early as 2 months after the partnership was formed, it was very clear to everyone that there would be no money available after construction -- and no money for working capital.

It was at this point that the banks suggested getting a second mortgage from the hospital owners, which was refused.

McKinney then tried to make drastic and unrealistic cuts in the estimate of construction costs -- which the builder specifically identified as only "possible savings" (Ex. LLLL) -- down from $530,000 to $436,000.

After McKinney made his unrealistic cuts (Oct 1965)

The breakdown was now as follows:

(1)	+ $750,000	total mortgage
(2)	- 250,000	expected bank advance for the property (plus $100,000 for investors)
(3)	- 436,000	construction (McKinney's attempt)
	+ $ 64,000	available after construction (less working capital required)

The banks made it clear in April, 1966 that there would be only $100,000 available from the mortgage to contribute to the purchase of the property. This meant the investors would now have to contribute $250,000 instead of $100,000 to purchase the property (cost $350,000). The bank also required a deposit of $75,000 to hold against future losses.

After the bank granted the mortgage commitment letter (Apr 1966)

Using the original construction estimate (not McKinney's), the picture was now as follows:

(1)	+ $750,000	total mortgage
(2)	- 100,000	expected bank advance for the property (plus $250,000 from investors)
(3)	- 530,000	construction (original estimate)
(4)	- 75,000	deposit for the bank
	+ $ 45,000	available after construction (less working capital required)

So, in April of 1966, a full 5 months before the property was even purchased, or any construction was started -- McKinney and everyone else knew that if the investors wanted to continue in the project, they would have to provide at least $250,000 to purchase the property, plus providing working capital, which any reasonable man could estimate to be at least $75,000.

At this point in time, McKinney and Simpson were not financially "hooked" onto the project. If they wanted to, they could have withdrawn, with a total loss at this point of only $17,000.

Note: Their combined capital account balance at this point was $52,333.00 of which $35,000 was a refundable deposit with the hospital, leaving a net balance of $17,333.00.

This loss figure is low because it was the builder who had been paying Fahey's salary of $400.00 per week since December of 1964, for a total of over $26,000 up to this point.

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Also, the hospital had provided free use of the building since February of 1965, and had also provided heat, light, maintenance, and security guards, all at no cost, and also paid the real estate taxes.

However, instead of talking "withdrawal" during this period, McKinney was praising Fahey in lavish terms for his ability in being able to obtain so favorable a mortgage, and for his over-all management of the project (See exhibits of McKinney's correspondence with Fahey in March, April and June of 1966).

In September of 1966, McKinney and Simpson produced the $250,000 in cash required to purchase the property (less the $35,000 on deposit), the bank added $100,000 to make up the $350,000, and construction started immediately.

During construction, Fahey managed exceedingly well, keeping the final cost to within 9% over the original estimate made two years before in February, 1965 -- this despite the addition of extra private rooms and baths made to take advantage of Medicare reimbursement rules that had just been published.

McKinney himself watched the project very closely. Not only did he have his own consultant watching over it (at the expense of the partnership), but he himself was up almost every week (as McKinney has testifed, and as the expense account sheets at the nursing home show), conferring with

Fahey, the architect, and the builder, all of whom were very much aware of the financial wisdom of keeping the costs down. These were all responsible people, and they in fact did an excellent job.

All changes were agreed upon by everyone in advance, but for billing convenience, these changes were grouped into only 4 change orders that were prepared, signed, and submitted some time after the changes were actually made. These change orders are what McKinney is using now to suggest to the Board that he didn't know about the changes until afterwards.

The final construction cost came to $577,300 which was an increase of $47,300 (9%) over the original estimate of $530,000. This left the financial picture as follows:

After completion of construction (May 1967)

(1)	+ $750,000	total mortgage
(2)	- 100,000	for the property -- (plus $250,000 from investors)
(3)	- 577,300	construction (final cost)
(4)	- 75,000	deposit for the bank
	- $ 2,300	available after construction (less working capital required)

This situation clearly left Fahey without any working capital after the opening in May -- which is why he had to make continued borrowings at the bank and why he finally engineered

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from the bank a large loan of $150,000 which he received the following year (April 1968), and from which McKinney and Simpson immediately took back $100,000, leaving Fahey to pay the builder $50,000 due him and also to manage the loan payments of $4,563.30 per month ($54,759.60 per year) from operations alone, again without working capital.

The blame for the whole situation could easily be pinned on McKinney for his unwise act in lowering the mortgage condition from $900,000 to $750,000 back in February of 1965.

But our basic point here in not to lay blame, but rather to show that everyone knew what the financial situation was all along the way -- and to refute, with the facts, the unsupported and grossly unfair statements made by McKinney.

The third point raised by McKinney is his attempt to sway this Board into achieving for him his plan to take over the entire nursing home operation by arguing that because Fahey and he have disagreed in the past, that they can no longer operate as partners and consequently, Fahey must go under Article 12. Such clearly is not the case.

POINT
III.

CONTROVERSY IS NOT A BASIS FOR EFFECTING DISSOLUTION BY EXPULSION

In McKinney's brief, we find repeated over and over again an idea that has absolutely no foundation in fact, but which is apparently presented to overcome the absence of any factual grounds to justify the involuntary withdrawal (buyout) of Fahey by McKinney.

The idea McKinney presents is that even if there are no grounds in Fahey's conduct as partner-administrator to justify his expulsion by involuntary withdrawal, the very fact that controversy exists between Fahey and McKinney should justify Fahey's forced removal.

This is a ridiculous concept -- to say that the mere existence of a controversy requires that Fahey be expelled.

McKinney presents this concept by using imaginary and colorful language to create the idea that these two partners, Fahey and McKinney, should not remain partners simply because McKinney himself says so, and therefore Fahey must go.

He has sprinkled his brief with words like "exploded," "war," "enemy," "reasonably impractical to do business with," "can never deal with each other again as partners," etc. -- all of which is really the language of dissolution, but only McKinney's version of dissolution -- that is, forcing Fahey to get out of the partnership, leaving it all to McKinney.

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Note: By using the language of dissolution, McKinney may be in strict violation of Article 10 of the partnership agreement.

He has presented this language of dissolution in 13 different pages of his brief (pages 2, 6, 48, 61, 78, 81, 87, 103, 112, 129, 132, 133, and 140). He sums up this position on page 133, last paragraph:

"...Thus, even if all the elements which require Fahey's expulsion for cause are ignored, the best interests of the partnership requires that the relationship between Fahey and McKinney be terminated ... through the withdrawal of Fahey pursuant to Article 12 ..."

We submit that what McKinney is trying to do with the language of dissolution is to inject an additional criterion for expulsion that has absolutely no basis in law or equity, and is also completely irrelevant to this case.

The only valid criterion for expelling a partner is the evaluation of the particular partner whose expulsion is being requested -- that is, whether the facts surrounding his conduct are such that they justify expulsion. If these facts do not justify expulsion, the matter is then settled.

What is at stake here is Fahey's individual right to continue as partner-administrator. The issue is not whether the partnership should be dissolved, or as McKinney puts it

"... the relationship between Fahey and McKinney be terminated..." simply because there has been controversy between them.

The so-called "warfare" has all been conducted entirely by McKinney himself. It was McKinney who mounted the all-out attack on Fahey that culminated in his temporary ex parte order physically forcing Fahey from the nursing home.

And now McKinney asks the Board to sanction his own wrongful conduct in breaching the partnership agreements, and to expel Fahey because he has dared to oppose his own expulsion.

Note: We could draw an analogy of our own regarding what McKinney is saying -- that it sounds exactly like what Russia would be saying to justify the invasion and takeover of Czechoslovakia -- that the affrontary of the Czechs in defending their rights against the Russian army created such a state of hostility that it could only be resolved by a complete Russian takeover in order to keep the peace in the future.

McKinney's contention that the mere existence of a controversy between two partners justifies the expulsion of one of the partners as a means of resolving the controversy has absolutely no basis in law or equity.

If McKinney really thinks he and Fahey should no longer be partners, that the relationship should be terminated, there is one clear way this can be achieved.

It is already part of the record that Fahey and McKinney have had personal negotiations regarding a selling price for Fahey to buy out the McKinney interests. At McKinney's request, Fahey put into writing a specific initial offer of $330,000.00.

If McKinney really wants to end the relationship, he can continue the negotiation, arrive at a mutually agreeable price, and thereby reach a parting of the ways that will be both peaceful and profitable.

If McKinney does not choose to end the relationship by selling to Fahey, then Fahey, as partner-administrator, will continue to respect McKinney's position as a partner as he has done in the past and in accordance with the provisions of the award issued by the Board.

The next point requiring further comment relates to the applicability of Article 8 governing depreciation. As pointed out in our original brief, this is the most important single threat to Fahey's present and future financial interest in the partnership.

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POINT
IV.

FAHEY'S INTEREST IN THE NET INCOME OF THE PARTNERSHIP-- AS AFFECTED BY ARTICLE 8 GOVERNING DEPRECIATION (AND BY ARTICLE 7 GOVERNING INCOME (PROFIT) BEFORE DEPRECIATION)

A. Article 8 governing depreciation must be given effect to determine the net income of the individual partners for 1968 and 1969

The determination of the individual partners' net income for 1968 and 1969 is governed by one absolutely incontrovertible point:

> Article 8, which allocates all the depreication to McKinney (85%) and Simpson (15%), and which was given effect in 1967, must also be given effect for the years 1968 and 1969.

There is absolutely no question or controversy over these two facts:

(1) The partners did incorporate Article 8 into the Agreement (at McKinney's own insistance).

(2) In 1967, the total depreciation of the partnership was allocated as prescribed in Article 8 -- 85% to McKinney and 15% to Simpson (1967 was the first year the nursing home opened, and therefore the first year in which depreciation was a factor in the calculation of the net income (profit) of the individual partners.)

We submit that these two facts mandate absolutely that Article 8 continue to be given effect in 1968, 1969 and thereafter.

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B. McKinney is now trying to capitalize on an accounting oversight in 1968

McKinney now wants to seize upon the "oversight" of the accountants in not applying Article 8 in 1968 and wants to make the oversight permanent. (See page 53 of our first brief).

The practical effect of this oversight was that the net income of the partners in 1968 was arrived at by using corporation rules instead of partnership rules.

In trying now to capitalize on the oversight, McKinney has even concocted some arguments about why Article 8 really did not apply in 1968. However, all his individual arguments are only parts of one single basic argument -- he now wants to arrive at individual net income by using corporation rules instead of partnership rules.

C. Corporation rules cannot be used to replace partnership rules in treating depreciation

In a corporation, the net income (profit) of the corporation is divided amongst the stockholders after depreciation has already been charged as an expense of the entire corporation. The share of profit received by a stockholder depends entirely on the shares of stock he holds. Thus, in a corporation, depreciation affects only the total amount of net income (profit) to be distributed; it has absolutely no relation to the percentage of the total profit distributed to a stockholder.

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Note: This is exactly the position taken by McKinney in his brief (pages 136 and 137), that the profits should be divided only after depreciation has been charged as an expense of the entire partnership.

This is not the case in a partnership, where the partners can agree not to treat depreciation as it is automatically treated in a corporation -- as a total expense of all the stockholders. Instead, the partners can agree to consider depreciation as an individual expense of each partner, which they can allocate to themselves in whatever proportion they agree upon. When this is done, depreciation automatically becomes an individual expense that must be distributed and applied as a means of arriving at the net income (profit) of each partner. It is elementary that different percentage allocations of depreciation will produce different results in net income.

Note: It is also elementary that a partner can deliberately take a large percentage of depreciation expense in order to give himself a loss in net income (profit), while his partners, with little or no depreciation expense, show a profit. This practice is highly lucrative for investors who seek to use the loss as a tax shelter for other income and/or for later years.

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Thus, in a partnership depreciation is not limited to affecting only the total amount of net income (profit), as it is in a corporation. When there are special allocations for depreciation, they can have a drastic effect in determining the resulting individual net income (profit) of each partner.

D. In a partnership agreement, a special provision on depreciation must be given effect

Consequently, since this partnership agreement contains a special provision for allocating depreciation to the individual partners, namely Article 8, this provision must be given effect.

Giving effect to Article 8 automatically dictates the basic partnership method of calculating the net income of individual partners -- as we have set forth in detail in our first brief. (See Tables 1, 2, and 3 in our first brief, pages 56, 68, and 69 respectively).

E. The allocations of Article 7 pertain to income (profit) before depreciation

In connection with these tables, we wish to make a special point about the entry on line (3), namely "Income (profit) before depreciation."

This is the line on which we entered the percentage allocations of "profit" provided for in Article 7 (7.2-7.3-7.4) of the Agreement.

According to what McKinney has been arguing in his brief,

he is really arguing (with respect to these tables) that the percentage allocations from Article 7 should not be made on line (3) at all. He is arguing they should be made on line (5), to divide only the net income (profit) of the partnership, and that the total depreciation should be charged only as an expense of the entire partnership, and should not be charged as an individual expense of each partner (which is what we have done on line (4) of the tables).

This, of course, is the old "corporation" argument we have already shown to be invalid because a partnership, by definition, requires the allocations to be made on lines (3) and (4) in order to give effect to the special depreciation provisions.

But we also can point to evidence that conclusively proves that McKinney and all the four partners knew and understood that Article 7 pertains to "cash-flow" profits at a level of about $100,000 without considering depreciation expense. This is the same "cash-flow" profit we have allocated on line (3) of the tables. We quote from pages 9 and 10 of McKinney's brief:

> "Thomas Fahey presented his brochure (Ex. 118) projecting an enticing cash flow of $98,000.00 per year ... Fahey's proposition to the investors, in simplified form is as follows: For a $100,000 investment, which could be returned within a year, would the investors be

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willing to share fifty-fifty with Fahey, $100,000 in annual profits which could begin the next year." (Emphasis added.)

The reference to sharing "...fifty-fifty with Fahey $100,000 in annual profits ..." together with the reference to Fahey's "brochure (Ex. 118)" shows the $100,000 level of profit as profit without depreciation. These references clearly provide independent support for the validity of applying the Article 7 allocations to distribute the income (profit) without depreciation on line (3) of the tables.

This is also logically borne out by the size of the figures involved, that is, the sharing fifty-fifty with Fahey "$100,000 in annual profits" could not possibly be confused with the mere $10,221.00 and $8,441.00 in partnership net income that results after depreciation of over $100,000 has been applied. In other words, the figures themselves show the partners were talking about dividing profits of the magnitude on line (3) of the tables ($100,000) and not on line (5) of the tables ($10,000).

We also wish to make another special point regarding Article 7 -- concerning McKinney's argument that the cumulative "interest" earned on his capital account under Article 7.2 is a first draw on the "profits" and that he now "has a claim on all future profits of the partnership to the amount of $90,509.97."

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(See page 138 of McKinney's brief).

Again, he is making an unsupported statement based on his "corporation" theory of applying the distribution of Article 7.2 to the net income of the partnership, that is, applying 7.2 to line (5) in the tables.

Note: The practical effect of McKinney's interpretation would be to deny Fahey any income (profit) at all for many years.

And again we say he is absolutely dead wrong. Again we say that the individual net income figures on line (5) of the tables must be the result of first applying the allocations on line (4) of the tables to the individual allocations on line (3).

The cumulative "interest" under 7.2 must be allocated on line (3) as "Income (profit) before depreciation" as one element of the Article 7 (7.2-7.3-7.4) income-sharing formula. We have already shown exactly how this cumulative "interest" is allocated to McKinney and Simpson in the year 1968. (See pages 61 and 62 of our first brief, and the "Combined Statement of Distribution of Depreciation and Income to Partners" for 1968 in Exhibit VVVV.)

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F. Article 8 has no separate tax role not related to individual income

We want to make one point very clear about the relationship of Article 8 to the taxable income of the individual partners. A partnership pays no income taxes. Only the individual partners pay income taxes. And what each partner pays is based on his individual net income as it appears in the audited annual financial statement of the partnership. This net income figure is taxed as ordinary income, whether the partner actually receives the money or not. The Government becomes aware of the amount of net income appearing on the annual report by requiring the partnership to file an information return spelling out all the financial details of the partnership, including the exact amounts of depreciation and net income allocated to each partner. Consequently, the net income of each partner is a highly significant tax figure for him as an individual.

It is therefore meaningless, and nothing more than a semantic smokescreen for McKinney to say in his brief (page 137) that "... Article 8 applied only for purposes of income tax and then to prevent Fahey as a non-contributing partnter from obtaining tax benefits of losses."

This statement means absolutely nothing in terms of the specific mechanics of arriving at the individual net income of a partner. And it is the individual net income alone that has tax consequences. If a partner wants a tax loss, he has to take

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a loss in net income, which means he gets no money from the partnership. If he wants money from the partnership, he has to pay taxes on it. He can't have it both ways -- despite what McKinney says to create that impression.

G. McKinney is now trying to have his depreciation both ways

We submit that this is what McKinney himself is now trying to do -- have it both ways.

The consequence of giving effect to Article 8 is that McKinney and Simpson receive losses in net income for 1968 and 1969, because of the large amount of depreciation they are charged with under Article 8.

It is obvious from the position McKinney is taking today regarding Article 8 that he no longer finds it to his advantage to be charged with losses, even though this is precisely and exactly what he demanded and received when he insisted that Article 8 be inserted into the general partnership agreement in November, 1965.

H. McKinney originally insisted that Article 8 should be included in the agreement

This was when the limited partnership agreement was being revised to conform to the New York State requirement that the nursing home must operate as a general partnership.

There was no special provision for depreciation in the limited partnership agreement. And even though it had been

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agreed by everyone that the change from one type of agreement to the other would be only a matter of form and not substance, McKinney nevertheless insisted that the new agreement contain a special provision allocating all the depreciation to McKinney (85%) and to Simpson (15%).

This demand by McKinney prompted the only controversy that took place over the new agreement. The main protagonists were Fahey and McKinney who had the two largest interests in the partnership and would be most vitally affected by how the depreciation was allocated.

McKinney then argued that he and Simpson as the investors, were entitled to be charged with all the depreciation expense if they wanted it. The significance of this demand is readily apparent to anyone familiar with the basic method of calculating net income of individual partners in a partnership.

It meant that the investors wanted to be certain they, as individual partners, would develop large losses in net income during the initial years of the project. This is done as a hedge against the financial uncertainties that could develop in the future. At this early stage, the uncertainties for the investors included:

(1) The obvious one that the success of the project could not be "guaranteed" by anyone.

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(2) There would certainly be operating losses for some unknown period of time.

(3) There was no certainty about when there would be enough cash-flow profits for the partners to draw on.

(4) Whenever the cash-flow expected at full occupancy did develop, it might nevertheless be encumbered by loans or other unexpected expenses; and if this condition occurred, the partners would show a taxable net income without having the cash-flow to distribute to the partners. (This would apply to all four partners).

Under these unpredictable conditions, McKinney and Simpson could assure themselves large individual losses in net income during this period by having all the depreciation expense charged to them. They each could then apply their individual losses to their individual tax returns:

(1) as a "current" tax shelter to cover income from other sources during this period.

(2) as a "carryover" tax shelter to cover income to be received in later years.

Also, by adopting a highly accelerated rate of depreciation expense, a very large tax shelter would be picked up very quickly, and in a few years McKinney and Simpson would have both a large tax shelter and a high cash-flow to draw on from the partnership.

This was all very nice for McKinney and Simpson, but it also left Fahey with the reverse situation. In the early years of operation, when McKinney and Simpson were showing a loss in net income, Fahey would be showing a corresponding profit in net income (because he would have no depreciation to charge as an expense). Thus, he would show a net income which he could not collect (because there would be no cash-flow to pay it), but on which he would be liable to pay substantial income taxes, without actually receiving the money.

What McKinney was insisting on was, in effect, a financial triple play at the expense of Fahey:

(1) McKinney was building up his own personal tax shelter at a time when he did not expect he would be able to draw any profit money anyway.

(2) He was doing this by shifting the tax liability on net income to Fahey.

(3) He was also putting Fahey in the position of having to pay the taxes out of his own pocket without any additional funds from the partnership.

Fahey, of course, objected vigorously to the whole scheme since he would literally be paying for it. He was completely opposed to taking the tax brunt during an unprofitable period as a financial scapegoat for McKinney.

McKinney insisted that the investors were entitled to this choice, and finally, Fahey, rather than hold up and

jeopardize the entire project, accepted the reason and yielded.

Thus, Article 8 became a part of the general partnership agreement. This all took place in Bill Murray's office in New York about a year and a half before the nursing home opened in May of 1967.

By the end of 1967, the partnership had been in existence for three years and the nursing home had been open for 8 months. McKinney and Simpson had received all the losses (as provided in Article 7.4) for all 3 years, and all the depreciation (as provided in Article 8) for 1967. By the end of 1967, McKinney had accumulated a tax shelter loss of over $197,000 and Simpson over $34,000, a total of over $231,000.00.

I. McKinney conducts pressure tactics on Fahey to change the agreement after the successful opening of the nursing home

However, during 1967, within only two months after the opening of the nursing home in May, the hitherto unpredictable economic picture had crystallized with a dramatic suddeness. The nursing home was filling up rapidly, the private patient rates and occupancy percentages were at favorable levels, expenses were in line with income, and the predictable economic future for the nursing home looked very rosy indeed.

All this created for McKinney an entirely different financial situation at the nursing home than he had hedged against in demanding all the depreciation in 1965. The first

few operational years would no longer carry the doubt of how long it would actually take to build up to a sizeable cash flow that the partners could share. Fahey was even now predicting a cash flow of over $100,000 for 1968. No one could absolutely guarantee that the cash flow would develop as Fahey was predicting, but it sounded very optimistic. And since Fahey was proving to be very effective as a manager, his prediction was evidence of a reasonable expectation of fulfillment.

McKinney and Murray immediately began to pressure Fahey to agree to a redrawing of the partnership agreement. This pressure began at a meeting of all the partners (except Metzger) in Bill Murray's office in New York (7/12/67) and continued through 1967 and 1968.

One device they used to pressure Fahey into changing the agreement was to claim that he was already "wiped out" by Article 12(H), and then, in a grand burst of almost embarassing generosity, they offered to "give" Fahey a 20% share of the profits with McKinney taking 80%.

Note: They also pressured Fahey still further with the threat of the cost of any arbitration proceeding that would be required to settle the question, which Murray estimated would cost Fahey about $20,000. Fahey accepted the arbitration challenge and said he would be willing to go into it right then if Murray was willing (at a meeting on 1/26/68 with Murray, McKinney, and

Simpson in Murray's office), but then Murray said there was no need to settle the question right now.

When Fahey did not accept their interpretation of Article 12(H), or their 20-80 offer, they then also offered to wipe out the cumulative 20% "interest" that had built up for McKinney and Simpson under Article 7.2 as a first charge on profits.

This was a completely hollow offer because it was obvious that the cumulative "interest" would be almost completely offset by the large depreciation expense that would be charged to McKinney by the allocation of Article 8. Furthermore, it appeared highly probable that in 1968, the partnership would generate enough total income (profit) before depreciation to be able to allocate to McKinney and Simpson all of the cumulative "interest" and still have some income left over for allocation to all the partners under Article 7.4. This would happen if Fahey's prediction about achieving over $100,000 of total income (profit) before depreciation was actually realized. This, in fact, did happen (See pages 61 and 62 of our first brief.)

Fahey did not accept the "improved" offer of eliminating the cumulative "interest."

Fahey's basic position to McKinney throughout was that he, Fahey, was standing on the partnership agreement, but he

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was also willing to discuss any proposed changes.

What happened instead, was more pressure -- Murray's move to buy out Metzger -- demands by McKinney to put Murray "into" the business as partnership attorney -- demands for co-signing of checks -- Fahey's counter-negotiations with Simpson to acquire sufficient protection to prevent McKinney from acquiring control of the business -- and finally the secret events leading up to the ex parte order.

Note: Fahey is not "bound" by his signature under the capital account balances for 1968. Rather, the accounting firm is bound to continue what they had previously started in 1967, giving effect to Article 8 by allocating the depreciation as provided for in the agreement.

The accounting firm has not prepared the annual financial report for 1969 because of the conflicting demands upon them by Fahey and McKinney regarding giving effect to Article 8 (plus 2 items of expense).

The firm has also not prepared the U.S. Partnership Tax Return for 1969 (which must include each partner's depreciation and net income) on the ground that the distribution of depreciation and net income are in dispute. Applications were also prepared for extenstions of time for filing each

partner's individual tax return for 1969.

If the Board rules that Article 8 must be given effect, the firm will also prepare an amended partnership return for 1968.

McKinney indeed wants to have it both ways, and he has shown that he doesn't care how he gets it.

But the agreement is clear and unavoidable. McKinney wanted Article 8 and he has it. He cannot change it now to serve his own purposes. He has to live with it.

One final point bears mentioning briefly, i.e. what affect should be given to the fact that Fahey now is a majority holder in interest.

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POINT V.

THE RELATIONSHIP OF FAHEY'S MAJORITY INTEREST TO THE FUTURE MANAGEMENT OF THE PARTNERSHIP

McKinney in his brief, is attempting to persuade the Board that they should completely overlook Fahey's majority interest in the partnership in the consideration of management rights. In fact, McKinney carries his argument to the extreme of claiming that Fahey has no managerial rights at all in the partnership.

Note: We are not dealing here with an absolute prohibition in the agreement against participation in management by any partner as was the situation in the Corr case cited on page 84 of his brief.

In our first brief, we have already presented our arguments in detail, showing Fahey's continuous managerial rights as they have existed in fact, and as they have existed under the provisions of all 3 partnership agreements.

McKinney has based his attempt to take over the management of the partnership entirely on his interpretation of Article 13, which we have shown does not give McKinney such power.

We have shown that Article 13 is clearly subordinate to all other provisions of the agreement by virtue of its own self-limiting language -- "Except as otherwise provided ... in these Articles ..."

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Article 13 is, therefore, subordinate to Article 7, which we have shown gives Fahey management rights that are inherent in the agreement itself (which cannot be changed except by all partners), and also specifically gives Fahey a vested right to manage the partnership as long as he wants to.

We have also shown that in the first 2 partnership agreements, the percentages of interest were controlling with respect to management rights.

(1) In the first agreement (November, 1964), management rights were specified in terms of <u>voting</u> rights, which were specifically identified with the profit percentages.

(2) In the limited partnership agreement, management rights were identified with the majority in interest of the general partners -- Fahey (45.0%) and McKinney (42.5%).

In the general partnership agreement, there is no specific identification of management rights with percentage interests -- which is why we now have the dispute over management rights.

However, we maintain that since Article 13 is subordinate to Article 7.4, and since one of the principle disputes in this case concerns the distribution of income to the partners, there is a direct and significant relationship between the management of the partnership and the extent of each partner's interest

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under Article 7.4.

We could make an argument claiming total management authority for Fahey based on his 52.5% interest, and seek a declaration to that effect.

However, Fahey does not choose to do so because he did not acquire the majority interest as a device for excluding McKinney from his minority rights as a partner.-- Fahey did this to only protect himself from this kind of attempt by McKinney.

Note: Fahey has never sought to exclude McKinney from his rights as a partner, even though McKinney has always been only a minority partner (42.5%), and Fahey always a plurality partner (45.0%) until he purchased Simpson's interest to make him the majority partner (52.5%).

Consequently, we submit that the majority interest is significant to the extent of the declarations we have requested regarding the continuation of Fahey's managerial functions in his capacity as partner-administrator.

TABLE A-1. INCOME SHARING UNDER THE 7.2-7.3-7.4 FORMULA-

Year	Capital account balance (average level during year)	Partnership Income before depreciation	7.2 McK & S	7.3 Fahey & M
(1)	$ 0	$ 100,000	$ 0	$ 0
(2)	10,000	"	2,000	2,000
(3)	50,000	"	10,000	10,000
(4)	100,000	"	20,000	20,000
(5)	200,000	"	40,000	40,000
(6)	300,000	"	60,000	40,000
(7)	400,000	"	80,000	20,000
(8)	300,000	"	60,000	40,000
(9)	200,000	"	40,000	40,000
(10)	100,000	"	20,000	20,000
(11)	50,000	"	10,000	10,000
(12)	10,000.	"	2,000	2,000
(13)	0	100,000	0	0

Note

* Levels of capital account over $100,000 within which Article 12(H) may c

OR VARIOUS LEVELS OF CAPITAL ACCOUNT

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7.4

Total	McK & S	Fahey & M
$100,000	$ 50,000 (50%)	$ 50,000 (50%)
96,000	48,000	48,000
80,000	40,000	40,000
60,000	30,000	30,000
20,000	14,000 (70%)	6,000 (30%)
0	0	0
0	0	0
0	0	0
20,000	14,000 (70%)	6,000 (30%)
60,000	30,000 (50%)	30,000 (50%)
80,000	40,000	40,000
96,000	48,000	48,000
100,000	50,000 (50%)	50,000 (50%)



perate. See discussion under "A" in Reply Brief.

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TABLE A-2. SUMMARY OF ANNUAL ALLOCATIONS OF INCOME BEFORE
FOR THE YEARS 1965 through 1969

"Interest" earned in capital account

Year	Balance during year (average)	20% "interest" (annually)	20% "interest" (cumulative)	Partnership income before depreciation
1965	$ 50,000	$ 10,000	$ 10,000	$ (loss)
1966	150,000	30,000	40,000	(loss)
1967	300,000	60,000	100,000	(loss)
1968 *				
(a)	100,000	6,000	106,000	106,000
(b)	0	0	0	14,000
				120,000
1969	0	0	0	108,000

Note

* In 1968, the capital accounts were reduced to "0" in April by withdrawi
All the figures used are rounded off to the thousands.

CIATION UNDER THE 7.2-7.3-7.4 FORMULA--

Distribution of Income Before Depreciation

7.2	7.3	7.4		
McK & S	Fahey & M	Total	McK & S	Fahey & M
0	0	(loss)	(loss)	0
0	0	(loss)	(loss)	0
0	0	(loss)	(loss)	0
$106 000				
0	0	$ 14,000	$ 7,000 (50%)	$ 7,000 (50%)
0	0	108,000	54,000 (50%)	54,000 (50%)

100,000.

(Arbitration Record Extracts — Group D) **
Index to Group D (Summaries of Subject Matter Covered in the Extracts).

D

RE: U.S. v. Thomas Fahey

GROUP D

Specific Extracts from Record in Arbitration

Extract	Items Covered in the Record
D-1 pp. 237-251	Specific offer made in January 1968 by taxpayer's partner to completely change partnership agreement and division of income. Offered to eliminate provisions on "depreciation", "losses", and "profit", including the "cummulative" on the capital account. Offered to eliminate everything and replace it with a straight 80%-20% split of "everything". Taxpayer did not accept on the ground the percentage was unfair since he was now claiming 45% of the "profits" under the agreement.
D-2 pp. 322-327	A year later, taxpayer's partner threatened to "end the partnership" over disagreements regarding certain disbursements - December 1968.
D-3 pp. 1222-1228	Taxpayer's partner asked minor partner (Simpson) to help him physically take over the business by locking the taxpayer out of his office at the meeting in January 1969, but the scheme was dropped. Simpson comments on attempts to resove the differences between the major partners. Sale of Simpson's interest to taxpayer.

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(Arbitration Record Extracts — Group D) **
Exhibit D-1 — Testimony on McKinney's offer to eliminate partnership agreement and substitute a straight 80%-20% split (Pages 237-251 of Arbitration Record).

Exhibit D-1 D-1

(Exhibit KK received in evidence.)

Q Now, on December 15th, 1967, was there a sale of some of the property which the corporation had previously purchased, a portion of it to the Texaco Company?

A That is correct. We sold a portion of the property that we had acquired from the Syracuse General Hospital which was not-- which was not required for our use to Texaco for $16,000.

Q They now put up a new gas station on that corner?

A The corner of Castle and Salina.

CHAIRMAN JACOBS: How much was that sold for?

THE WITNESS: 16,000. One small portion of the existing station.

ARBITRATOR DEVORSETZ: You sold them an additional parcel?

THE WITNESS: That is correct. It was a house next door-- they had a station there, and we sold them the house next door to it.

Q Now, what was the next visit of Mr. McKinney and Dr. Simpson to Syracuse?

A On January 11th and 12th, 1968, they both came to Syracuse.

Q Did you have a conference concerning the

business of the corporation, the partnership, at that time?

A We certainly did.

Q Would you tell us who was present at that conference and where it was?

A Yes. It was conducted at Castle Rest, and we started off early in the morning and Mr. McKinney and Dr. Simpson and I, and we were later joined, about mid morning, by Mr. Metzger.

In the early part of the morning I gave a rather detailed presentation on the physical operation of Castle Rest. We had been open for seven months now, and were just hitting our break even point. We opened the previous May. We were still having some real rough sledding and there was a lot of early details hanging over our heads which I was coping with and we had quite a discussion on those, but we had turned the corner; we had finally broken even.

CHAIRMAN JACOBS: What day was this that you broke even?

THE WITNESS: This was in January.

Q '68?

A '68.

CHAIRMAN JACOBS: You broke even on operating expenses, as far as operating the home goes?

THE WITNESS: That is correct, yes.

CHAIRMAN JACOBS: Okay.

THE WITNESS: In that meeting, after I gave my presentation, Mr. McKinney repeated the arguments that were given in Mr. Murray's office the previous July regarding Articles 7.2, 3 and 4 of the partnership agreement, and claiming that I was wiped out of any profit sharing because the investment had reached, had peaked up to somewhere in the neighborhood of $330,000.

I repeated all my arguments that went over in Mr. Murray's office six months previously, and this, there had been conversation back and forth in the intervening six month period.

CHAIRMAN JACOBS: Could I ask you something?

THE WITNESS: Yes, surely.

CHAIRMAN JACOBS: This time, this last conversation took place, where did it take place?

THE WITNESS: You mean the one in January?

CHAIRMAN JACOBS: January of 1960--

THE WITNESS: It started in my office, and I didn't-- we convened to a special, to a private room up in the fourth floor of the

nursing home because we didn't want any nursing home--

CHAIRMAN JACOBS: Who was present at the time?

THE WITNESS: Dr. Simpson and Mr. McKinney and I, at this particular portion.

CHAIRMAN JACOBS: What time of the day was this? Do you know?

THE WITNESS: It was about ten-thirty in the morning when we got into this aspect.

We started off at breakfast, and I gave an operational report and then the argument came up again about this wiped out thing because of the capital investment.

CHAIRMAN JACOBS: What did he say was wiped out at that time?

THE WITNESS: He said, because the capital investment, the capital account had reached, had peaked up somewhere in the neighborhood of three hundred twenty to three hundred thirty thousand, that according to the partnership agreement that I was wiped out and I had no share, no interest in the partnership, and no share in profit of the partnership.

I said I didn't interpret the partnership agreement that way and that he

was referring to the third division of profits only and ignoring the first two divisions of profit, which was basically the 50-50 deal, and again those are arguments as I related last time, that had occurred in Mr. Murray's office six months previously.

Mr. McKinney, at this meeting, suggested that we rewrite the partnership agreement; that I accept a 20 percent straight interest in the partnership and it be stated that way rather than a division of profit based on capital account.

I did not agree with this position, and I said I was not in any way wiped out, and we left the meeting, I think, all in a very unsatisfied condition, and Mr. Murray— or Mr. McKinney asked if I would meet him in New York in a couple of weeks with Dr. Simpson, and we could talk about it again, and I said sure, we would meet and talk about it again.

Q At this point Mr. McKinney, after reiterating his position, stated to you that he would rewrite the partnership agreement and give you a 20 percent interest; is that right?

A Suggested that the partnership, yes, that the

partnership agreement be rewritten and just state it in straight partnership interest. Also that they overcome, that they would forget about-- there was a provision in there, the first division of profit, being 20 percent on the capital account cumulative from the time the monies were put in, and in addition to redefining the interest on a straight 20 percent for me, that they would forget about the cumulative that had been reached at that point.

CHAIRMAN JACOBS: I don't follow you.

THE WITNESS: Okay.

CHAIRMAN JACOBS: Could you take it--

THE WITNESS: Maybe I ought to refer to the agreement.

CHAIRMAN JACOBS: I think we are familiar with the agreement. I don't follow your explanation. You are talking cumulative and the rest of it. Keep it in the categories.

ARBITRATOR DWORSETZ: What is the cumulative?

THE WITNESS: The agreement provides for first division of profits shall be 20 percent on the capital account, cumulative from the time the money is put into the project.

Now, there were monies invested in 1965 and monies were in the capital account

in 1965, but we were earning no profit in '65 and there was money in, in '66, and we were earning no profits in '66, but the 20 percent of the capital account was a first draw on profit at such time as they would be earned, was accumulating.

ARBITRATOR DWORSETZ: In other words, the amount of the capital account would be a sum total of the contributions at different stages up to the time that the profits were to be disbursed or distributed; is that it?

THE WITNESS: Let's use the number example.

If there were $25,000 in the project in 1965, for instance, and no profits were earned in 1965, but the investors were entitled to 20 percent of the capital account in 1965, or $5,000 would accumulate, credit of $5,000 would accumulate at such time as profits were earned, and it would be a first draw on profit.

I think the language of the agreement says "cumulative from the time of the investment."

That would be a first draw on profit, at such time as the profit were earned.

(Arbitration Record Extracts — Group D) **
Exhibit D-1 — Testimony on McKinney's offer to eliminate partnership agreement and substitute a straight 80%-20% split (Pages 237-251 of Arbitration Record).

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We had that situation in 1965 and we had it in '66 and now we had it in '67.

CHAIRMAN JACOBS: So they were getting 20 percent return on 25,000--

THE WITNESS: They were earning.

CHAIRMAN JACOBS: For each additional year; is that correct?

THE WITNESS: That is correct, yes.

CHAIRMAN JACOBS: Plus additional capital as they were put in?

THE WITNESS: As the capital, for the time that the capital account was intact for every day that there was a set sum of dollars in the capital account, they were earning 20 percent annual interest rate on that monies.

It would be distributed to them at such time as profits were produced. It would be a first draw on subsequent profits.

Q That is 20 percent a year, and that adds up each year?

A Right.

Q So that--

CHAIRMAN JACOBS: That is cumulative?

THE WITNESS: Right. From the time the money was invested.

ARBITRATOR MALONEY: So as an example, if they put another twenty-five in in 1966, and they would get 20 percent in '66 on fifty?

THE WITNESS: That is correct. It would be added on.

CHAIRMAN JACOBS: To five before?

THE WITNESS: So it would be fifteen thousand, the first distribution of profits, they would be entitled--

CHAIRMAN JACOBS: Would you be entitled to fifteen thousand for the corresponding years also?

THE WITNESS: No. That would be a first draw, and from then on it would be a year to year basis when we caught up with the cumulative.

CHAIRMAN JACOBS: All right.

Q Was there anything else discussed of any import at that meeting on January 12th?

A No. We agreed that we would get together again, and Mr. McKinney wanted to meet in his apartment in New York to discuss it, and I agreed, I was open to discuss it further.

Q On January 25th of 1968 did you go to New York for the purposes of carrying out further discussion concerning this matter?

A Yes, I did.

(Arbitration Record Extracts — Group D) **
Exhibit D-1 — Testimony on McKinney's offer to eliminate partnership agreement and substitute a straight 80%-20% split (Pages 237-251 of Arbitration Record).

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Q Where was that discussion had and who was present?

A The discussion was held in the morning of January 25th, 1968, in Mr. McKinney's apartment, and Dr. Simpson and Mr. McKinney and I were present.

Q What discussion was had?

A We got into the same topic, again, and the point made, because the capital account had reached $330,000 that I had no share in the profit distribution of the partnership; therefore, no interest in the partnership.

MR. MURRAY: I allowed considerable latitude, and would you mind having him say who said what, and Mr. McKinney said and what Dr. Simpson said and what he said?

Q If you could recall who said what, state it. You don't know the exact words, I take it.

A Dr. Simpson was mainly silent in these discussions. Mr. McKinney and I did most of the talking.

Q What did Mr. McKinney say?

A Mr. McKinney claimed again that I had been wiped out because of this capital account peaking at 330,000, approximately, and he tried to convince me to agree to a rewrite of the partnership agreement, spelling out a straight 20 percent interest for Fahey, and Metzger was not concerned and he would still have

(Arbitration Record Extracts — Group D) **
Exhibit D-1 — Testimony on McKinney's offer to eliminate partnership agreement and substitute a straight 80%-20% split (Pages 237-251 of Arbitration Record).

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his 5 percent, and then 75 percent to be divided between Dr. Simpson and Mr. McKinney, based on a ratio of their investment.

Q Did he also make any offer concerning the cumulative profit provision?

A Yes. He suggested that as an inducement to do this that we forget about the cumulative, and that the straight percentages would apply immediately, and that the cumulative clause on eventual profit would be wiped out.

Q What did you state?

A I said that I would rather stick with the partnership agreement as it was made, and this was a 50-50 deal from the beginning, and that I would stick with it with the deal we made, and I didn't want to change the partnership agreement.

Q Was that, in essence, the substance of your discussion at that trip to New York?

A Mr. McKinney was very upset about my position in the matter and said, "I am not satisfied with this. I insist that we go down and see Murray tomorrow and discuss it in his office."

Q Did you go to Murray's office the next day?

A We stayed overnight and met in Mr. Murray's office the next morning.

Q Who met in Mr. Murray's office?

A Mr. McKinney, Dr. Simpson, I and Mr. Murray.

Q Would you tell us what the discussion was at that time?

A May I refer to my notes for just a minute here?

Q Yes.

ARBITRATOR MALONEY: This is January, '68?

THE WITNESS: This was January 26th, 1968.

Q The meeting that you had at Mr. McKinney's apartment was on the 25th?

A That is correct.

Q This is the following day, which would be the 26th?

A That is correct.

ARBITRATOR DEVORSETZ: Was Dr. Simpson there?

Q Dr. Simpson, Mr. Murray and Mr. McKinney and yourself?

A That is correct.

Q Murray and yourself?

A That is correct. We met again the next morning and Mr. Murray had been apprised of the fact that I didn't agree with the interpretation of the partnership agreement as it was given to me, and Mr. Murray said that he ought to know what it meant, that he, it was his agreement and who was more qualified to

interpret it than he was, and he agreed wholeheartedly with Mr. McKinney's position, that I indeed had been wiped out of the partnership.

Q Did he make any other comments concerning this?

A Well, he said he was disappointed in me that I hadn't agreed with Mr. McKinney the day before, and that just to check the point out he had had two lawyers working all night long looking into the law on the, on the point.

Q Did Mr. Murray mention the proposed new agreement of the 20-80 split?

A Indeed he did. He suggested that if I was smart, I would take it and forget about my position regarding the Article 7.2, 3 and 4 relationship.

Q What did you respond?

A I flatly agreed to do it.

ARBITRATOR MALONEY: To do what?

THE WITNESS: To submit to a change, to a rewrite of the partnership agreement spelling out an 80-20 percent arrangement.

Q You agreed to it?

A I said I refused to agree.

Q I think we heard you say, "I agreed to do it."

A I flatly disagreed to submit to a revision of the partnership agreement. Well--

Q Was any mention made about arbitration at that point?

A Yes, it was.

Q Tell us about that, and just go through these as we can, and we will speed it up. Go ahead and tell us who said what right through the meeting.

A We had kind of a deadlock as to the interpretation of these particular clauses of the agreement, and I said we ought to be able to get this thing interpreted for us, if we can't agree we ought to be able to get the thing interpreted for us, and he said, "Yeah, we could go to arbitration and get it settled, but that will cost you $20,000."

I said, "Well, I would be very happy to put this question up to an impartial interpretation."

Q Who said that?

A I said that.

Q Who said it would cost you $20,000?

A Mr. Murray.

Q Did Mr. Murray make any--

A And when I said, after I replied in that manner, there was quite a bit of silence, and then Mr. Murray said, "Well, there is no reason to settle the question now, and you have got your work to do up there and we can settle this any time."

We kind of had reached an impasse then, and the meeting became social rather than business, and on the way out Mr. Murray suggested that it might be wise of me to sell my interest in the partnership for, to Mr. McKinney for something in the neighborhood of $300,000, and then to take a management contract to still administer the nursing home at a salary of about $35,000 a year.

I didn't pay much— I didn't give this any serious attention, and it was said as an aside on the way out, and I did not respond to that.

Q Up to this point, Mr. Fahey, had there been any dispute in relation to operating the nursing home business between you and Mr. McKinney?

A None whatsoever.

Q Were you operating the nursing home up to this point?

A Completely, yes.

Q Now, was that all, in essence, that was discussed in the meeting at Mr. Murray's office?

A Yes.

Q On February 9, 1968, was there some correspondence between Dr. Simpson and yourself?

A What was the date?

Q February 9th, 1968.

(Arbitration Record Extracts — Group D) **
Exhibit D-2 — Testimony on McKinney's threat to end the partnership in December 1968 (Pages 322-327 of Arbitration Record).

[Exhibit D-2] D-2/1

A Yes. After this.

Q Did you have a meeting with Mr. McKinney in Syracuse on December 18th, 1968?

A Yes, I did.

Q Did you discuss general financial business of the partnership?

A Yes, we did.

Q Was anything else discussed of any significance?

A No. Nothing of any significance, great significance with regard to partnership relationships.

Q On December 20, 1968 did you receive a phone call from Mr. McKinney?

A I did.

Q What was the conversation you had with him at that time?

A Mr. McKinney asked me if I paid the Jackson, Nash legal bill that had been received, dated September 6th, '68, and I said I had not.

He said that he wanted it paid and I said, well, I said I don't know, I want to check it out and I haven't had a chance to check the bill out yet, and he said he wanted it paid and I said-- he also said if I had taken my car off the Castle Rest books yet and I said no, I had not--

Q Did Mr. McKinney give you any ultimatum at

(Arbitration Record Extracts — Group D) **
Exhibit D-2 — Testimony on McKinney's threat to end the partnership in December 1968 (Pages 322-327 of Arbitration Record).

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that point?

A He said if I didn't do these things it would be the end of the partnership.

Q Was that the substance of that phone conversation?

A Yes.

Q Did you receive a letter dated December 20, 1968, from Mr. McKinney?

A The same day, yes.

Q Do you have a copy of that?

A Yes, I do. It was a registered letter, incidentally.

(Exhibit TT marked for identification.)

MR. MC CURN: I offer for the record a letter dated December 20, 1968, from Mr. McKinney to Mr. Fahey.

CHAIRMAN JACOBS: Any objection?

MR. MC CURN: Consisting of two pages.

MR. MURRAY: No objection.

CHAIRMAN JACOBS: Received.

(Exhibit TT received in evidence.)

(Exhibit UU marked for identification.)

CHAIRMAN JACOBS: This letter of December 20 states that you are to take certain action prior to the time that you were told to pay the bill of William E. Murray dated September 6th, 1968.

(Arbitration Record Extracts — Group D) **
Exhibit D-2 — Testimony on McKinney's threat to end the partnership in December 1968 (Pages 322-327 of Arbitration Record). D-2/3

Was there any consultation among the partners concerning that particular bill?

THE WITNESS: Yes, there had been, there had been communication back and forth.

CHAIRMAN JACOBS: Among all the partners?

THE WITNESS: Just McKinney and I.

CHAIRMAN JACOBS: Was there consultation among all the partners?

THE WITNESS: On that particular bill?

CHAIRMAN JACOBS: Right.

THE WITNESS: There was some conversation with Dr. Simpson about the bill.

CHAIRMAN JACOBS: It is a simple question I am asking you.

THE WITNESS: Yes.

CHAIRMAN JACOBS: Among all the partners.

THE WITNESS: No. Metzger-- I do not recall Metzger being involved in the conversation.

CHAIRMAN JACOBS: How about the sale of your station wagon? Was there conversation among all the partners on that?

THE WITNESS: I think all except Metzger.

CHAIRMAN JACOBS: How about reducing the salary? Was there consultation among all the partners on that?

(Arbitration Record Extracts — Group D) **
Exhibit D-2 — Testimony on McKinney's threat to end the partnership in December 1968 (Pages 322-327 of Arbitration Record).

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THE WITNESS: All except Metzger, and I don't recall him participating.

CHAIRMAN JACOBS: You are testifying here that there wasn't consultation by all the partners prior to the time that the action in this letter was taken; is that right?

THE WITNESS: Yes.

Q On January 8th, 1969, did you have a meeting in Syracuse with Mr. McKinney?

A I did.

Q What transpired at that time?

MR. MURRAY: What was that date?

MR. MC CURN: January 8, '69.

A On January 8 of this year we had a regularly scheduled meeting, and Mr. McKinney arrived alone, and I had been expecting Dr. Simpson at this meeting and he did not make the meeting, and it was a rather-- we went through our regularly monthly routine, a rather abbreviated kind of a meeting. I received a telephone call--

Q At the meeting did you discuss the ultimatums set forth in the December 20th, '68 letter?

A No, we didn't. It was an abbreviated formal kind of a meeting and we didn't get into anything controversial at that particular meeting.

(Arbitration Record Extracts — Group D) **

Exhibit D-2 — Testimony on McKinney's threat to end the partnership in December 1968 (Pages 322-327 of Arbitration Record). D-2 326

Q Later on that particular evening, did you get a phone call from Dr. Simpson?

A I did.

Q What was the substance of the conversation, and who said what in that?

A Dr. Simpson told me that Mr. McKinney had asked him to accompany me to Syracuse-- accompany him to Syracuse for the meeting.

Q That was the meeting that was held that day which he didn't attend?

A That day which he did not attend, and he said that he just couldn't come to the meeting, and he wanted to know what Walker did, and he asked how the meeting had gone, and I said it would seem to me it was a very reserved kind of a meeting and we didn't get into the controversy subjects that had cropped up. It was an abbreviated meeting, and he said that was strange because he had been contacted by Mr. McKinney to accompany, for Dr. Simpson to accompany McKinney to Syracuse on that day, Dr. Simpson-- Mr. McKinney wanted him to participate in a plan wherein Dr. Simpson would divert me from the premises and Mr. McKinney would contact all the key nursing home personnel and offer them substantial salary increases and lock me out of my office and deny me any access to my records and papers, and just lock

(Arbitration Record Extracts — Group D) **

Exhibit D-2 — Testimony on McKinney's threat to end the partnership in December 1968 (Pages 322-327 of Arbitration Record). D-2/6 327

me out.

Dr. Simpson would not participate in this plan, and he said he couldn't participate in the plan.

Q I show you Exhibit UU marked for identification, which is a letter from Harry LeBien, attorney, to William E. Cass, attorney, dated January 17, 1969, and ask you if you received a copy of that? Is that the copy that you received?

A Yes, this is-- I had a copy of this letter, correct.

Q Mr. Cass at that time was William Cass, the attorney here in Syracuse?

A Yes. By this time I had decided that I needed some counsel and this is a couple of months previous, I had retained Mr. Cass to represent me.

Q Was Mr. Cass representing you at the time?

A Yes, he was.

Q Mr. LeBien was Dr. Simpson's attorney?

A That is correct.

MR. MC CURN: I think you have seen that.

I offer that in evidence.

I will withdraw my offer and lay some more foundation.

Q It appears that paragraph A of that letter refers to an enclosed letter. Was there any enclosed

(Arbitration Record Extracts — Group D) **
Exhibit D-3 — Testimony on partner Simpson's refusal to join McKinney in tactics against Fahey, and sale of Simpson's interest to Fahey (Pages 1222-1228 of Arbitration Record).

Exhibit D-3 D-3

Q Tell us about those.

A Well, realizing the vulnerability of my position, I decided I would talk to Mr. Fahey, and decided to negotiate with him, and to sell out my interest to him.

Q Now, did there come a time in September of 1968, or thereabouts, that you had a conference with, or conversation with Mr. McKinney relative to removing Mr. Fahey as administrator?

A Yes.

Q Tell us when that occurred and what was said.

MR. KEMPLE: What was the date?

MR. MC CURN: September of 1968, on or about that time.

A Not that early, no.

Q When was it that you did have some?

A It was about in December of '68 or January of '69.

Q What did Mr. McKinney say and what did you say?

A At this time Mr. McKinney told me that he was, that he couldn't allow Tom Fahey to become indispensable, and that he would have to fire him. He suggested that we go to Syracuse and that I

take Tom Fahey out to breakfast while he informed the supervising personnel of the nursing home of a change in administration, while increasing their salaries twenty per cent in order to keep them on and retain their loyalty.

Q When was this?

A This was in, I am not sure when he first suggested it. I think it was in November or December of '68, and I was to go up in January of '69 with him to do this.

Q Did you do it?

A No.

Q Did you tell McKinney that you would not do it?

A No. I just didn't go.

Q Did you have any conversation with Fahey about this?

A Not immediately, no. I didn't inform him about this because I didn't -- I was, I was trying to get them to work together, and resolve their differences so that we would have a nicely-functioning business, and not all this controversy.

CHAIRMAN JACOBS: You say differences, and what were the differences that you knew at that time?

(Arbitration Record Extracts — Group D) **
Exhibit D-3 — Testimony on partner Simpson's refusal to join McKinney in tactics against Fahey, and sale of Simpson's interest to Fahey (Pages 1222-1228 of Arbitration Record). D-3 3 1224

THE WITNESS: Mainly involved Mr. McKinney felt that he wasn't being kept informed of details of the operation of the nursing home by Mr. Fahey, and he was upset that he wasn't getting frequent enough reports from Mr. Fahey.

Q Was there some discussion, or were you aware of any dispute in relation to Mr. Murray's legal fees?

A Oh, yes. You see, Mr. Fahey explained to me that at the end of the year he would have to justify expenses to the Medicare and Medicaid people, including the $600. a month retainer to Mr. Murray; since our legal bills were nowhere that, he felt that this would be fraudulent, and he refused to go along with Mr. McKinney's insistence that this be, this retainer be put into effect, and it was because of Mr. Fahey's intransigence that he said, "Well, all right, your salary goes back to $20,000., from 24, and you have got to buy back your car from the nursing home" and so forth.

Q By "he", do you mean Mr. McKinney?

A Mr. McKinney wanted, with Mr. Fahey.

Q Yes. Now, did you eventually culminate a proposed sale of your interest to Mr. Fahey?

A Yes.

(Arbitration Record Extracts — Group D) **
Exhibit D-3 — Testimony on partner Simpson's refusal to join McKinney in tactics against Fahey, and sale of Simpson's interest to Fahey (Pages 1222-1228 of Arbitration Record). D-3 4

Q When was that?

A March 12, 1969.

Q Was that by means of a document entitled "Conveyance of Interest from George Simpson to Thomas Fahey", dated March 12, 1969?

A Yes.

MR. MC CURN: Which, I believe, is in evidence.

(At this point a short recess was taken)

CHAIRMAN JACOBS: Please note the appearances, and we will continue where we left off.

BY MR. MC CURN: (continuing)

Q Referring to the Conveyance of Interest of George Simpson to Thomas Fahey of March 12, '69, which you identified, were you subsequently paid $45,750. for your interest?

A Yes.

Q Now, while you were carrying these negotiations on with Mr. Fahey, to purchase your interest, did you acquaint Mr. McKinney of this?

A No.

Q What was your purpose in not doing so?

A Well, I was scared I would be, I would be bought out for $15,000., and Mr. Murray himself had said that meeting in his office, July 24, '68, with the $15,000. buy-out, and much larger cash

input, in his words, he said, "Simpson is getting screwed", and his agreement of November 5, '68 with the ceiling but no floor, didn't make me feel much better, give me much reassurance.

Q Was it then that you consulted with Mr. LeBien as counsel?

A Yes.

Q Did Mr. LeBien act as your counsel in connection with the agreement dated March 12, 1969?

A Yes.

Q Do you know whether or not Mr. Fahey had counsel at that time, too?

A I believe he did.

Q Mr. Murray was no longer representing you; is that right?

A That's right.

Q Since your graduation from medical school, and your post graduate training, have you had occasion to work in hospitals and other medical facilities?

A Yes, indeed.

Q Have you, in connection with that work, made observations as to patients' care and treatment?

A Of course.

Q During your connection with Castle Rest

Nursing Home did you have an opportunity to observe the method and manner of care being given to the patient during the administration of Thomas Fahey?

A Yes. It was one of my great pleasures, because when we went on rounds --

MR. MURRAY: Objection.

Q Your answer to that is yes?

A Yes.

Q What did your observations consist of?

A Well, when Tom and I would go from bed to bed, he would know the patients by their first names, and the morale there was absolutely superb among the employees; the patients' care, I have a number of letters of appreciation from relatives of patients, and from patients, and from visitors, showing their opinions, too, which backed up my feeling of what a first-class facility Tom was running.

Q In relation to the medical care aspects of it, do you have an opinion?

A The patients were beautifully taken care of, and they --

Q Go ahead.

A Well, I could go on at length about them, because I was proud as a physician to be involved in a nursing home where we had a sincere interest in the

welfare of the individual patients, and it was not a used people lot, which so many of them are. I was -- and the financial return made me very happy to be part of this, and also reluctant to leave it.

Q Why did you leave it?

A Because my investment was jeopardized, as far as I could see, and I had no real feeling of security.

MR. MC CURN: I think that is all of Dr. Simpson.

(Settlement and Financing Papers — Group E) *
Index to Group E.

E

RE: U.S. v. Thomas Fahey

GROUP E

Settlement Papers (Including Financing Documents) 1

Exhibit E-1 Oct./1972	General Release - To Thomas Fahey from Walker and Jane McKinney.	1
Exhibit E-2 10/20/72	Business Certificate - Thomas Fahey succession in interest to Walker McKinney and Jane McKinney.	1
Exhibit E-3 10/19/72	Bill of Sale - Personal property of nursing home sold to Castle Rest Facilities Corp. by Walker and Jane McKinney.	2
Exhibit E-4 10/19/72	Deed - Real property conveyed to Castle Rest Facilities Corp. by Walker and Jane McKinney.	3
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(Settlement and Financing Papers — Group E) *
Exhibit E-1 — General Release To Thomas Fahey from Walker and Jane McKinney (Oct./72).

R 110—General Release—Individual.

JULIUS BLUMBERG, INC., LAW BLANK PUBLISHERS
80 EXCHANGE PLACE AT BROADWAY, NEW YORK

To all to whom these Presents shall come or may Concern,

Greeting: KNOW YE, That

Ex. E-1

Jane W. McKinney, and
Walker McKinney

for and in consideration of the sum of One and No/100 dollars ($1 00) lawful money of the United States of America to them in hand paid by

Thomas M. Fahey

the receipt whereof is hereby acknowledged, have remised, released, and forever discharged and by these presents do for their heirs, executors, and administrators and assigns, remise, release and forever discharge the said

Thomas M. Fahey, his

heirs, executors, administrators, successors and assigns of and from all manner of actions, causes of action, suits, debts, dues, sums of money, accounts, reckoning, bonds, bills, specialties, covenants, contracts, controversies, agreements, promises, variances, trespasses, damages, judgments, extents, executions, claims and demands whatsoever, in law, in admiralty, or in equity, which against

Thomas M. Fahey, they

ever had, now have or which their heirs, executors, or administrators, hereafter can, shall or may have for, upon or by reason of any matter, cause or thing whatsoever from the beginning of the world to the day of the date of these presents.

This release may not be changed orally.

In Witness Whereof, we have hereunto set our hands and seals the day of October 19 72

Sealed and delivered in the presence of

Walker McKinney L.S.
Walker McKinney, individually and as attorney in fact under
Jane W. McKinney

William E. Murray, as attorney in fact for Jane W. McKinney

State of New York County of Onondaga ss.:

On the day of October 1972 before me personally came Walker McKinney, and also William E. Murray, as attorney in fact for Jane W. McKinney

to me known, and known to me to be the individual s described in, and who executed the foregoing instrument, and duly acknowledged to me that he executed the same

[illegible]
Notary Public
Onondaga County
My Commission [illegible]

Settlement and Financing Papers — Group E) *

Exhibit E-2 — Business Certificate, Thomas Fahey succession in

Interest to Walker M. Kinney and Jane McKinney (10/20/72).

Business Certificate

Fah E-2

I HEREBY CERTIFY *that I am conducting or transacting business under the name or designation*

of CASTLE REST NURSING HOME

at 116 E. Castle Street

City or Town of Syracuse *County of* Onondaga *State of New York.*

*My full name is** Thomas M. Fahey

and I reside at 415 Stratford Street, Syracuse, New York 13210

I FURTHER CERTIFY *that I am the successor in interest to*

Walker McKinney and Jane W. McKinney

the person or persons heretofore using such name or names to carry on or conduct or transact business.

IN WITNESS WHEREOF, *I have this* 20th *day of* October *1972, made and signed this certificate.*

Thomas M. Fahey

Thomas M. Fahey

* Print or type name.

* If under 21 years of age, state "I am_____years of age".

STATE OF NEW YORK }
COUNTY OF ONONDAGA } ss.:

On this 20th *day of* October *1972, before me personally appeared*

Thomas M. Fahey

to me known and known to me to be the individual described in and who executed the foregoing certificate, and he thereupon duly acknowledged to me that he executed the same.

RALPH J. BATTICCI
Notary Public in the State of New York
Qualified in Madison Co. Fee. 51540[illegible]
Commission Expires March 30, 19 74

(Settlement and Financing Papers — Group E) *
Exhibit E-3 — Bill of Sale, Personal property of nursing home sold to Castle Rest Facilities Corp. by Walker and Jane McKinney (10/19/72).

To Have and to Hold the same unto the said parties of the second part, their executors, administrators and assigns forever. And they do , for their heirs, executors and administrators, covenant and agree to and with the said parties of the second part, to Warrant and Defend the sale of the said tangible personal property hereby sold unto the said parties of the second part, their executors, administrators and assigns, against all and every person and persons whomsoever.

In Witness Whereof: We have hereunto set our hands and seals this 18th day of October Nineteen Hundred and Seventy-two.

In Presence of

Walker McKinney (L. S.)

Jane W. McKinney (L. S.)

(L. S.)

State of New York,
County of NEW YORK } ss.:
of

On this 18th day of October Nineteen Hundred and Seventy-two before me, the subscriber, personally appeared WALKER McKINNEY and JANE W. McKINNEY

to me personally known and known to me to be the same persons described in and who executed the within Instrument, and they acknowledged to me that they executed the same

Wilhelmina D. Fennell

WILHELMINA D. FENNELL
Notary Public, State of New York
No. 06-6-540
Qualified in Nassau County
Certificate filed in New York County
Commission Expires March 30, 19 74

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Bill of Sale

WALKER McKINNEY and
JANE W. McKINNEY, Partners,
d/b/a Castle Rest Nursing
Home and d/b/a Castle Rest
Home for Adults,

TO

CASTLE REST FACILITIES
CORPORATION, and
RALPH J. BALDUCCI.

Dated, October 18, 1972

Filed, 19

(Settlement and Financing Papers — Group E) *
Exhibit E-3 — Bill of Sale. Personal property of nursing home sold to Castle Rest Facilities Corp. by Walker and Jane McKinney (10/19/72).

Know all Men by these Presents,

That WALKER McKINNEY and JANE W. McKINNEY, Partners d/b/a Castle Rest Nursing Home and d/b/a Castle Rest Home for Adults, parties

of the first part, for and in consideration of the sum of

------FORTY THOUSAND and no/100----------Dollars ($ 40,000.00) lawful money of the United States, to us in hand paid, at or before the ensealing and delivery of these presents, by CASTLE REST FACILITIES CORPORATION, a corporation organized under the laws of the State of New York, with offices located at 300 Wilson Building, Syracuse, New York, and RALPH J. BALDUCCI, parties

of the second part, the receipt whereof is hereby acknowledged, ha ve bargained and sold, and by these presents do grant and convey unto the said part ies of the second part, their executors, administrators and assigns, all of the furniture, fixtures, furnishings, equipment, books, records, accounts and all other items of personal property used by parties of the first part in the operation of the business stated above, $34,500
all of the inventory and supplies of said business, 5,500
Total $40,000

A schedule of the items referred to above is attached hereto as Exhibit "A" and has been checked by the parties of the second part against the card index thereof maintained on the premises of the parties of the first part by its Purchasing Agent, Francis Gravelle.

(Settlement and Financing Papers — Group E) *
Exhibit E-4 — Deed, Real property conveyed to Castle Rest Facilities Corp. by Walker and Jane McKinney (10/19/72).

E-4 (A)

DEED BOOK 2687 PAGE 791

CONSULT YOUR LAWYER BEFORE SIGNING THIS INSTRUMENT—THIS INSTRUMENT SHOULD BE USED BY LAWYERS ONLY.

CITY

5372 R

Stamps $1,320.00

10665

THIS INDENTURE, made the 18th day of October, nineteen hundred and Seventy-two

BETWEEN CASTLE REST NURSING HOME, a partnership, having its principal place of business located at 116 East Castle Street, Syracuse, New York,
Comprising of members as follows: (1) Walker McKinney, residing at 40 East 66th Street, New York, New York; and (2) Jane W. McKinney, residing at 40 Mid Oak Road, North Muskegon, Michigan,

party of the first part, and

CASTLE REST FACILITIES CORPORATION, a corporation organized under the laws of the State of New York, with offices located at 415 Stratford Street, Syracuse, New York,

party of the second part,

7:00 P.M. —CCS PM OCT-1972 3 52

WITNESSETH, that the party of the first part, in consideration of ONE AND 00/100 - - -

(Settlement and Financing Papers — Group E)*
Exhibit E-4 — Deed, Real property conveyed to Castle Rest Facilities Corp. by Walker and Jane McKinney (10/19/72).

E-4

DEED

BOOK 2487 PG 792

TOGETHER with all right, title and interest, if any, of the party of the first part in and to any streets and roads abutting the above described premises to the center lines thereof,

TOGETHER with the appurtenances and all the estate and rights of the party of the first part in and to said premises,

TO HAVE AND TO HOLD the premises herein granted unto the party of the second part, the heirs or successors and assigns of the party of the second part forever.

AND the party of the first part covenants that the party of the first part has not done or suffered anything whereby the said premises have been incumbered in any way whatever, except as aforesaid.

AND the party of the first part, in compliance with Section 13 of the Lien Law, covenants that the party of the first part will receive the consideration for this conveyance and will hold the right to receive such consideration as a trust fund to be applied first for the purpose of paying the cost of the improvement and will apply the same first to the payment of the cost of the improvement before using any part of the total of the same for any other purpose.

The word "party" shall be construed as if it read "parties" whenever the sense of this indenture so requires.

IN WITNESS WHEREOF, the party of the first part has duly executed this deed the day and year first above written.

IN PRESENCE OF:

CASTLE REST NURSING HOME

By Walker McKinney
Walker McKinney, Partner

By Jane W. McKinney
Jane W. McKinney, Partner

CASTLE REST FACILITIES CORPORATION

By Thomas McFahey
Thomas M. Fahey, President

(Settlement and Financing Papers — Group E) *

Exhibit E-4 — Deed, Real property conveyed to Castle Rest Facilities Corp. by Walker and Jane McKinney (10/19/72).

E-4

DEED 0887 248 PAGE 793

STATE OF NEW YORK, COUNTY OF —

On the 19th day of October, 1972, before me personally came Walker McKinney, to me known to be a member of the firm of Castle Rest Nursing Home, the firm described in and which executed the foregoing instrument, and acknowledged that he executed the foregoing instrument for and in behalf of said firm.

WILHELMINA D. ITHAELL
Notary Public in the State of New York
No. 31-6[illegible]
Qualified in [illegible] County
Certificate filed in New York County
Commission Expires March 30, 1974

STATE OF NEW YORK, COUNTY OF —

On the 19th day of October, 1972 before me personally came Jane W. McKinney, to me known to be a member of the firm of Castle Rest Nursing Home, the firm described in and which executed the foregoing instrument, and acknowledged that she executed the foregoing instrument for and in behalf of said firm.

WILHELMINA D. ITHAELL
Notary Public in the State of New York
No. 31-6[illegible]
Qualified in [illegible] County
Certificate filed in New York County
Commission Expires March 30, 1974

STATE OF NEW YORK, COUNTY OF Onondaga

On the 19th day of October 1972, before me personally came Thomas M. Fahey to me known, who, being by me duly sworn, did depose and say that he resides at No. 415 Stratford St. Syracuse, New York; that he is the President of Castle Rest Facilities Corporation, the corporation described in and which executed the foregoing instrument; that he knows the seal of said corporation; that the seal affixed to said instrument is such corporate seal; that it was so affixed by order of the board of directors of said corporation, and that he signed his name thereto by like order.

RALPH J. BALDUCCI
Notary Public in the State of New York
Qualified in Madison Co. No. 5154700
Commission Expires March 30, 1974

STATE OF NEW YORK, COUNTY OF

On the day of 19, before me personally came the subscribing witness to the foregoing instrument, with whom I am personally acquainted, who, being by me duly sworn, did depose and say that he resides at No.

that he knows to be the individual described in and who executed the foregoing instrument; that he, said subscribing witness, was present and saw execute the same; and that he, said witness, at the same time subscribed h name as witness thereto.

RECORD AND RETURN TO:

[illegible] CORP.

Title No.

Castle Rest Nursing Home

TO

Castle Rest Facilities Corporation

Bargain and Sale Deed
WITH COVENANT AGAINST GRANTOR'S ACTS

The land affected by the within instrument lies in Section in Block on the Land Map of the County of

RECORDED AT REQUEST OF

Read & Return to Sarcia Bar Lucci & Wilson 1514 dy. Syracuse, N.Y. 13202

STANDARD FORM OF NEW YORK BOARD OF TITLE UNDERWRITERS
Distributed by
THE TITLE GUARANTEE COMPANY
GUARANTEED 1883 IN NEW YORK

RESERVE THIS SPACE FOR USE OF RECORDING OFFICE

ONONDAGA COUNTY CLERKS OFFICE
Deed, Recorded on the 19th day of Oct. 1972 at 3:52 P.M. in Book 887 Page 793
and examined.
Calvin D. Hamilton, Clerk

(Settlement and Financing Papers — Group E) *
Exhibit E-5 — Closing Statements (10/19/72).

Oct. 19, 1972

Exh. E-5

CLOSING STATEMENT

WALKER McKINNEY & JANE W. McKINNEY
TO
CASTLE REST FACILITIES CORPORATION

Prem. -
(1) 116 E. Castle St., Syracuse, N.Y.
(2) 1428 So. State Street " "
(3) 1434 So. State Street, " "
(4) 1438-40 So. State St., " "

Adjustments as of Oct. 19, 1972

PURCHASE PRICE		$1,767,000.00
Taxes:		
#1- 116 E. Castle St., -	$35,218.48	
2 mon. 10 days @ $2,934.87/mo.		6,847.98
#2- 1428 So. State Street -	$753.88	
2 mon. 10 days @ $62.83/mo.		156.54
#3- 1434 So. State St.	$1,046.92	
2 mon. 10 days @ $87.24/mo.		203.48
#4- 1438-40 So. State St.	$828.00	
2 mon. 10 days @ $69.00/mo.		161.00
TOTAL PURCHASE PRICE		$1,774,369.00

CREDITS TO PURCHASER:

Marine Midland Mtg. -			
Princ. balance	$597,675.36		
Int. to 10/19/72 @ $99.61	1,892.63		
		$599,567.99	
Fulton Bank Mtg.-			
Principal bal. -	8,217.83		
Int. to 10/19 @ 1.37	26.03		
		8,243.86	
Solvay Bank-			
Principal balance	560.51		
Int. to 10/19 @ $.094	1.79		
		562.30	
Mills Mortgage-			
Principal balance	621.43		
Int. to 10/19	4.42		
		625.85	
		$609,000.00	
Deed stamps		1,320.00	
Abstracts - B/D		91.00	
Tax abstracts		40.00	
TOTAL CREDITS TO PURCHASER			$610,451.00
BALANCE DUE ON CLOSING			$1,163,918.00

Paid on closing:

Check No. 10481	$1,130,000.00	
Check No. 10483	33,918.00	
		$1,163,918.00

SALE OF CASTLE REST NURSING HOME E-5

October 19, 1972

CLOSING MEMORANDUM

The Closing was held at the offices of Monroe Abstract & Title Corporation in Syracuse, New York on October 19, 1972. Attending the closing were Walker McKinney and his counsel, William E. Murray and Donald Kemple, as Sellers. Also attending were Thomas Fahey and his counsel, Ralph Balducci, as Purchasers. Representatives of the Monroe Abstract & Title Corporation and the Rochester Savings Bank were also present. The latter included Mr. Robert Mooney, Counsel.

REAL ESTATE

Sellers' price . . .			$1,850,000.00
Credits to Seller:			
Tax adjustment CRNH Building 2 mos. 10 days on $35,218.48	$6,847.94		
Tax adjustments, houses:			
(1)	156.54		
(2)	203.48		
(3)	161.00		
	$7,369.00		7,369.00
		Total Agreed Selling Price	$1,857,369.00
Credits to Purchaser:			
Down payment, arbitration award		$ 83,000.00	
Marine Midland mortgage	$597,675.36		
Interest on mortgage	1,892.63		
	$599,567.99		
Fulton Bank -			
Principal	$8,217.83		
Interest	26.03		
	$8,243.86	$ 8,243.86	
Solvay Bank -	560.51		
Interest	1.79	$ 562.30	
Mills mortgage	621.43		
Interest	4.42	$ 625.85	
Total Mortgage Indebtedness Principal and Interest . .	609,000.00	$609,000.00	
Deed Stamps -		1,320.00	
Abstracts - B/D		91.00	
Tax Abstracts		40.00	
		693,451.00	693,451.00
NET SALES PRICE			$1,163,918.00
Check No. 10481			1,130,000.00
		Balance	$ 33,918.00
Check No. 10488			33,918.00
		Balance	$ - 0 -

(Settlement and Financing Papers — Group E) •
Exhibit E-5 — Closing Statements (10/19/72).

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CLOSING - 2.

Sale of business pursuant to contract dated August 17, 1972:

Sales Price	$50,000.00
Deposit	5,000.00
Balance	$45,000.00
Check from Purchaser, No. 10490	45,000.00
Balance	- 0 -

Adjustments to Purchase Price:

Balance sheet of business assets transferred - Cash	$ 90,287.00	
Accounts receivable	133,905.00	
Employee advances	300.00	
Combined Inventories:		
$6,827.00		
1,884.00	8,711.00	
Prepaid Expenses:		
Service systems	4,000.00	
Traveler's Insurance	751.00	
Workmen's Compensation	2,933.00	
TOTAL ASSETS TRANSFERRED		$240,887.00

LIABILITIES:

Accounts payable	$ 52,498.00
Non-invoiced purchases	5,717.00
Accrued accounts payable	90,996.00
Patients' Funds on deposit	24,169.00
Prepaid Service	18,329.00
Total Liabilities Assumed	$191,709.00
Difference between assets transferred and liabilities assumed	$ 49,178.00
Check received from Purchaser No. 10489	49,178.00
BALANCE DUE	- 0 -

SUMMARY:

Total checks received -

Check No. 10431	$1,130,000.00
Check No. 10488	33,918.00
Check No. 10490	45,000.00
Check No. 10489	49,178.00
TOTAL	$1,258,096.00
Deposit at Murray, Patterson & Sharpe	5,000.00
Realty Escrow from Marine-Midland	2,442.24
TOTAL RECEIPTS	$1,265,538.24

CLOSING - 3.

TOTAL RECEIPTS		$1,265,538.24
Less payables not assumed by Purchaser:		
Supplementary compensation (McCarthy)	$13,297.82	
TV Radio contract	2,025.00	
E. Suffolk	31,479.83	
E. Suffolk II	12,538.74	
Lincoln Leaseway I	13,899.83	
Lincoln Leaseway II	26,853.09	
	$100,094.31	100,094.31
Net proceeds receivable . . .		$1,165,443.93

COMMENTARY:

At the Closing, after the checks had been exchanged, the Purchaser made claim for some $17,000 of estimated expenses for alleged violation to the Home for Adults. I pointed out to him that the contract for the sale of the premises provided that they accept "as is" and that the covenant against violations extended only to the Nursing Home. After much argument and discussion Mr. Fahey directed his counsel to abandon this claim for adjustment. Mr. Fahey, Mr. McKinney and I then proceeded to the Castle Rest Nursing Home where possession was turned over to Mr. Fahey. At about 8:00 P.M. the matter was concluded. In order that all adjustments be considered final and that no warranties, adjustments because of mathematical errors or other contingencies survive the Closing, Mr. Fahey gave a general release to Castle Rest Nursing Home, Mr. McKinney and Mrs. McKinney, dated October 20, 1972, and said parties likewise granted a general release to Mr. Fahey on such date.

WEM:afk

W.E.M.

(Settlement and Financing Papers — Group E) *
Exhibit E-6 — Agreement for Purchase and Sale of Business
(8/17/72).

8/17/72 Exh E 6

AGREEMENT

for

PURCHASE AND SALE OF BUSINESS

AGREEMENT made and entered into this 17 day of August, 1972 by and between

WALKER McKINNEY and JANE W. McKINNEY, partners, d/b/a CASTLE REST NURSING HOME, and d/b/a CASTLE REST HOME FOR ADULTS, parties of the first part, hereinafter referred to as "Seller", and

CASTLE REST FACILITIES CORPORATION, a corporation organized under the laws of the State of New York, with offices located at 300 Wilson Building, Syracuse, New York, party of the second part, hereinafter referred to as "Purchaser",

W I T N E S S E T H:

WHEREAS, Seller is desirous of selling the certain nursing home business being conducted under the name and style of Castle Rest Nursing Home and Castle Rest Home for Adults at 116 East Castle Street, in the City of Syracuse, New York, and Purchaser is desirous of buying the same.

NOW, THEREFORE, in consideration of the sum of FIVE THOUSAND DOLLARS ($5,000.00) paid by the Purchaser to the Seller hereof, the receipt of which is hereby acknowledged, which payment shall be credited on the purchase price hereinafter mentioned, the parties hereto agree as follows:

1. Sale of Business -

Seller does hereby agree to sell the business to be sold to Purchaser and Purchaser does hereby agree to purchase all of the

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furniture, fixtures, furnishings, inventory, equipment, books, records, accounts, supplies and Good Will and all other items of personal property used by Seller in the operation of the business known as or being conducted under the names of Castle Rest Nursing Home and Castle Rest Home for Adults.

2. Consideration -

The purchase price for the business and personal property hereinabove referred to shall be:

A) The sum of FIFTY THOUSAND DOLLARS ($50,000.00); and

B) Purchaser shall take said business subject to the unpaid claim of Jefferson-Franklin Corp. and Nicholas A. Courtessis and shall hold Seller harmless from any obligation in connection therewith.

3. Terms -

Purchaser agrees to pay the purchase price by executing a promissory note in the amount of FORTY-FIVE THOUSAND DOLLARS ($45,000.00), payable on demand, together with a security agreement as prescribed by the Uniform Commercial Code.

4. Closing -

A) The closing hereof shall be held not later than October 31, 1972, or at such other earlier time as the parties hereto shall mutually agree.

B) The closing shall be held at the offices of Love, Balducci and Scaccia, 300 Wilson Building, 306 South Salina Street, Syracuse, New York, or at such other place as the parties hereto shall mutually agree.

5. Bill of Sale -

At closing hereof, Seller shall execute and deliver to

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Purchaser Bill of Sale with full warranty of title transferring all items of personal property and equipment used in connection with the operation of said nursing home business, free of all claims, liens, encumbrances, leases and leasing agreements. Such Bill of Sale shall then be placed in escrow with Seller's Attorney pending payment of the promissory note in the said sum of FORTY-FIVE THOUSAND DOLLARS ($45,000.00) in accordance with its terms and pending the closing and transfer of title to said real property.

6. Operating Assets and Liabilities -

A) For purpose of facilitating the continuance of the business with uninterrupted service and the transfer of same to the Purchaser, Seller shall transfer and assign certain of the operating assets of the value of $127,000.00 being items as follows:

Cash on hand and in Bank	$27,000.00
Accounts receivable - trade	80,000.00
Prepaid expense	14,500.00
Supplies	5,500.00
Total	$127,000.00

B) In consideration of the transfer of said assets, Purchaser assumes and agrees to pay certain operating liabilities in the sum of $127,000.00, being items of account as follows:

Accounts payable other than the Jefferson-Franklin claim	$ 45,000.00
Accrued expense	60,000.00
Patients' funds on deposit	22,000.00
Total	$127,000.00

C) If the certain operating assets listed in (A), supra, exceed the certain operating liabilities in (B), supra, the Seller may reduce the cash assets, or increase the amount of the demand note, or part of one and part of the other, as they deem advisable.

D) Upon final closing and transfer of title to the realty as provided in an agreement of even date herewith, any differences between the value of the certain assets transferred and the certain

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Jerrold
MH

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obligations assumed by Purchaser shall be adjusted accordingly.

7. Possession -

Possession shall be delivered to Purchaser at a time to be mutually agreed upon which shall be at the end of the normal work shift, if practical.

8. Representations of Seller -

Seller represents, warrants and covenants as follows:

A) Purchaser shall have the right to the exclusive use of the names "Castle Rest Nursing Home", and "Castle Rest Home for Adults", in the continuance and conduct of the business and Seller shall execute any and all instruments that may be required in connection with the assignment of such right.

B) Should Purchaser require Seller agrees to comply with New York State Uniform Commercial Code dealing with bulk transfer of business whether or not Article 6 thereof is specifically applicable thereto.

C) That there is no litigation, proceeding or claim pending or threatened against the Seller's operation of the nursing home business excepting as hereinabove referred to.

D) That all current assets and liabilities now in fact appear on the books of the business.

E) That there are no commitments in existence regarding additional expenditures, other than those incurred in the normal course of day-to-day business, that would create a liability at any future time either before or after possession by Purchaser.

F) That prior to January 2, 1973 Purchaser will make no withdrawals from the business, make no payments to Jefferson-Franklin Corp., and that no expenditures will be made other than

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those required for the day-to-day operation of the business, except that a distribution or salary to Thomas M. Fahey in the amount of $750.00 per week may be made, weekly.

9. Lease of Real Property -

A) Seller hereby agrees to lease the real property located at 116 East Castle Street, Syracuse, New York at a monthly rental of TEN THOUSAND DOLLARS ($10,000.00), computed from the date of possession to date of transfer of title to the said real property as provided by agreement of even date.

B) The lease shall be a net lease, whereby the amount of monthly rental shall be over and above all the operating expenses which shall be the obligation of Purchaser, with exception of interest and principal payments on any mortgages or leasing agreements.

C) Purchaser may withhold payment of the monthly rental pending the closing and transfer of title to said real property, at which time the accrued rent shall be due and payable.

10. Delay in Closing -

In the event the closing and transfer of title to said real estate shall not occur prior to January 1, 1973, then this Agreement shall terminate and the Seller's attorney shall return the promissory note, general release of Thomas M. Fahey, and the down payment of FIVE THOUSAND DOLLARS ($5,000.00) to the Purchaser and the Bill of Sale to the Seller. All profit inuring to the business shall belong to the Seller and the Purchaser shall be paid therefrom the sum of THREE THOUSAND DOLLARS ($3,000.00) per month for his services hereunder.

11. Binding Provisions -

This Agreement shall bind the respective heirs, executors,

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administrators, assigns and successors in interest of Seller and Purchaser.

Executed by the parties hereto the date first above written.

Walker McKinney, Seller

Jane W. McKinney, Seller

CASTLE REST FACILITIES CORPORATION

By Thomas M. Fahey, President

Thomas M. Fahey, Guarantor

(Settlement and Financing Papers — Group E) *
Exhibit E-7 — Agreement of Exchange of Realty (8/17/72).

8/17/72

Exh E-7

AGREEMENT OF EXCHANGE OF REALTY

THIS AGREEMENT, made this 17th day of August, 1972, between WALKER McKINNEY, 40 East 66th Street, New York, New York, and JANE W. McKINNEY, 40 Mid Oak Road, North Muskegon, Michigan, hereinafter described as party of the first part, and

CASTLE REST FACILITIES CORPORATION, with offices located at 300 Wilson Building, 306 South Salina St., Syracuse, New York, hereinafter described as party of the second part,

W I T N E S S E T H:

1. Exchange of realty -

A) Party of the first part, in consideration of ONE ($1.00) Dollar paid, the receipt of which is hereby acknowledged, and of the conveyance by party of the second part hereinafter agreed to be made, hereby agrees to exchange and convey to party of the second part, at an equity valuation for the purpose of this contract of ONE MILLION ONE HUNDRED SEVENTEEN THOUSAND & 00/100 ($1,117,000.00) Dollars, parcels of real property described in Schedule "A" annexed hereto.

Said premises described in Schedule "A" are to be exchanged and conveyed, subject to a mortgage being serviced by Marine Midland Bank-Central which indebtedness shall not exceed the sum of SIX HUNDRED FIFTY THOUSAND & 00/100 ($650,000.00) Dollars. Any reduction in indebtedness under the amount specified in this paragraph shall require an increase in equity valuation as set forth in the first unnumbered paragraph hereof.

B) The party of the second part, in consideration of ONE ($1.00) Dollar, the receipt of which is hereby acknowledged, and of the conveyance by the party of the first part hereinbefore agreed to be made, hereby agrees to exchange and convey to party of the first part at an equity valuation for the purpose of this contract of ONE MILLION ONE HUNDRED SEVENTEEN THOUSAND & 00/100 ($1,117,000.00) Dollars, parcel of real property described in

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Schedule "B" annexed hereto.

Said premises described in Schedule "B" are to be exchanged and conveyed subject to any indebtedness set forth in said Schedule "B".

2. Building Violations -

Notices of violations of law or municipal ordinances, orders or requirements noted in or issued by any State, Federal or Municipal Department having jurisdiction against or effecting the premises described in Schedule "A" hereof shall be complied with by party of the first part and the premises shall be conveyed free of the same and this provision shall survive delivery of the deed hereunder.

3. Closing -

A) If for any reason party of the second part cannot exchange and convey the premises described in Schedule B prior to October 31, 1972, unless without additional expense to second party, lending institution shall consent to the extension of such commitment expiration date to December 31, 1972, then second party may require a closing by the conveyance of premises described in Schedule "A" for cash in the amount of ONE MILLION ONE HUNDRED SEVENTEEN THOUSAND & 00/100 ($1,117,000.00) Dollars, subject only to mortgage indebtedness not exceeding SIX HUNDRED FIFTY THOUSAND & 00/100 ($650,000.00) Dollars, and adjusted as set forth in Article "1" for any reduction thereof.

B) The closing shall be held at the offices of Love, Balducci and Scaccia, 200 Wilson Building, 306 South Saline Street, Syracuse, New York, or at such other place as may be designated by the lending institution involved in this transaction.

4. Deeds -

At the closing hereof, each party shall transfer and convey title to the other by warranty deed with lien covenant, conveying good and marketable title, free of all liens and encumbrances, with exception of items of indebtedness herein set forth.

5. Possession -

Unless possession of premises described in Schedule "A" has been sooner delivered to second party pursuant to the terms of a lease to be agreed upon, said possession shall be delivered on the day of closing and transfer and/or exchange of titles.

6. Adjustments -

Interest, insurance premiums, rents, utilities and taxes shall be pro-rated and adjusted as of the date of closing and transfer of the respective titles, excepting that with regard to premises described in Schedule "A", adjustments shall be made as of the date possession is delivered pursuant to terms of any lease that may be negotiated.

7. Insurance -

Until the closing, the buildings on the properties shall be kept insured by the record owners thereof against loss by fire in an amount not less than the amount presently maintained. In case of loss, any insurance proceeds shall be allowed to the purchaser (grantee) if purchaser elects to take the property in accordance with the terms of this Agreement, notwithstanding the injury or destruction, or the purchaser may rescind the agreement and all obligations shall cease.

8. Conditions -

This agreement for the exchange of premises is conditioned upon party of the second part securing certain funds from a lending institution pursuant to a commitment which said second party warrants is presently issued and binding, subject only to

approval of title and closing matters by the lending institution attorneys with respect to the premises herein agreed to be conveyed by first party.

This Agreement is also conditional upon second party securing such approvals as may be necessary for the uninterrupted conduct of the nursing home business as required by said lending institution.

9. Representations -

A) There is no litigation, proceeding or claim pending or threatened against either of the parties hereto involving the parcels of real property described in Schedules "A" and "B", excepting such matters of litigation involving first party and Thomas M. Fahey, the discontinuance and settlement of which shall merge with this transaction and shall be further evidenced by the exchange of mutual general releases.

B) Each of the parties shall furnish to the other with respect to the premises intended to be conveyed, immediately following the execution hereof, should same be requested, abstracts of title, tax abstracts, current tax receipts, survey showing all improvements constructed on said parcels to be free and clear of encroachments, copies of insurance policies, as well as such other documents and instruments as may be required by grantees' attorneys for title examination purposes.

10. Binding Provisions -

This Agreement shall be freely assignable and the provisions hereof shall bind the respective heirs, executors, administrators, assigns and successors in interest of the parties hereto.

EXECUTED by the parties hereto the date first above written.

Walker McKinney
Walker McKinney

Jane W. McKinney
Jane W. McKinney

CASTLE REST FACILITIES CORPORATION
By Thomas M. Fahey
Thomas M. Fahey, President

Thomas M. Fahey
Grantor

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SCHEDULE A

1. 116 East Castle Street, being a nursing home located at the intersection of East Castle Street and South State Street, Syracuse, New York;

2. 1428 through 1440 South State Street, Syracuse, New York, improved by three (3) dwelling structures.

SCHEDULE B

Premises as described in Deed to Purchaser attached hereto and valued at $1,167,000 net over encumbrances as listed therein.

(Settlement and Financing Papers — Group E) *
Exhibit E-8 — Addendum to Agreements of Exchange of Realty and Purchase and Sale of Business (8/17/72).

Exh E-8

ADDENDUM TO AGREEMENTS OF EXCHANGE OF REALTY AND PURCHASE AND SALE OF BUSINESS.

This Addendum to Agreements made as of the 17th day of August, 1972, between WALKER McKINNEY and JANE W. McKINNEY, herein described as party of the first part, and THOMAS M. FAHEY as Guarantor, CASTLE REST FACILITIES CORPORATION and RALPH J. BALDUCCI, herein described as party of the second part,

W I T N E S S E T H :

WHEREAS, party of the second part has entered into and presented to party of the first part two Agreements, one for the Purchase and Sale of the Business known as Castle Rest Nursing Home, and the other for the Exchange of Realty, both dated August 17, 1972, and

WHEREAS, party of the second part has deposited and paid over to the party of the first part the sum of FIVE THOUSAND and no/100 ($5,000.00) Dollars and a General Release from THOMAS M. FAHEY to WALKER McKINNEY and CASTLE REST NURSING HOME, and

WHEREAS, the parties wish to add to and amend said Agreements so that they are acceptable to the party of the first part,

NOW, THEREFORE, this Addendum,

1. No representative of the party of the second part shall enter the premises or communicate with the employees of the party of the first part without the express permission of WILLIAM E. MURRAY at any time prior to the closing hereunder.

2. Article 2 of Exchange of Realty is hereby amended to read as follows:

"The party of the first part represents that there are no violations of law or of municipal ordinances or any orders or requirements noticed in or issued by any State, Federal or Municipal Department having jurisdiction against the premises

described in Schedule A herein which prevent the operation of the principal premises as a nursing home, and the party of the second part agrees that the principal premises and the adjoining houses shall be conveyed to it 'as is' and this provision shall survive delivery of the Deed hereunder."

3. Article 4 of Exchange of Realty is hereby amended to read as follows:

"4. Deeds -

At the closing hereof, the party of the first part shall transfer and convey title to the party of the second part a quit claim deed with covenants against its own acts conveying title free of all liens and encumbrances except those existing and permitted by the mortgage being serviced by the Marine Midland Bank-Central and an existing right of way to the present premises owned by Bonne Music and situated on Salina Street, and subject to items of indebtedness herein set forth, and party of the second part shall transfer and convey title to the other by quitclaim deed with covenant against its own acts conveying title, free of all liens and encumbrances, with exception of items of indebtedness herein set forth."

4. Article 10 for the Purchase and Sale of Business is hereby amended to read as follows:

"10. Delay or Failure to Close -

In the event the closing and transfer of title to said real estate shall not occur prior to January 1, 1973, then this Agreement and the Agreement of Exchange of Realty shall both terminate and the parties agree that the damages sustained are as follows, and these provisions shall be determinative regardless of any other provision of law, agreement for arbitration or otherwise:

A. If for any reason party of the first part refuses to exchange said realty or sell said business then, and in such event, it shall pay to party of the second part the sum of EIGHTY-THREE THOUSAND and no/100 ($83,000.00) Dollars as liquidated damages, and furthermore shall return the down payment of FIVE THOUSAND and no/100 ($5,000.00) Dollars and the General Release of THOMAS M. FAHEY, but

B. If for any reason party of the second part refuses or is unable to exchange said realty or purchase said business, then

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party of the first part shall retain that portion of the down payment consisting of the General Release of THOMAS M. FAHLY as liquidated damages and shall return that portion of the down payment consisting of its cash deposit of FIVE THOUSAND and no/100 ($5,000.00) Dollars to the party of the second part.

Executed by the parties hereto as of the date first above written.

Walker McKinney
WALKER McKINNEY

Jane W. McKinney
JANE W. McKINNEY

CASTLE REST FACILITIES CORPORATION

By Thomas M. Fahly
THOMAS M. FAHLY, President

Thomas M. Fahly
THOMAS M. FAHLY

Ralph A. Balducci
RALPH A. BALDUCCI

(Settlement and Financing Papers — Group E) *
Exhibit E-9 — Second Addendum to Agreements of Exchange of Realty and Purchase and Sale of Business (10/19/72).

Exh E-9

SECOND ADDENDUM TO AGREEMENTS OF EXCHANGE OF REALTY AND PURCHASE AND SALE OF BUSINESS

This Second Addendum to Agreements and Addendum made as of the 17th day of August, 1972, by and between WALKER McKINNEY and JANE W. McKINNEY, partners, d/b/a CASTLE REST NURSING HOME, and d/b/a CASTLE REST HOME FOR ADULTS, parties of the first part, hereinafter referred to as "Seller", and

CASTLE REST FACILITIES CORPORATION, a corporation organized under the laws of the State of New York, with offices located at 300 Wilson Building, Syracuse, New York and Thomas M. Fahey, party of the second part, hereinafter referred to as "Purchaser",

W I T N E S S E T H:

WHEREAS, parties have entered into two Agreements, one for the purchase and sale of the business known as Castle Rest Nursing Home, and the other for the exchange of realty, both dated August 17, 1972, and have also entered into an Addendum to said Agreements, and

WHEREAS, the parties wish to add to and amend said Agreements to provide as follows:

NOW, THEREFORE, this Second Addendum,

1. Article 2 of Agreement for Purchase and Sale of Business is hereby amended to add thereto the following paragraphs denoted C):

"C) The purchase price of Fifty Thousand ($50,000) Dollars shall be allocated as follows: $10,000 to the good-will of the business known as or being conducted under the names of Castle Rest Nursing Home and Castle Rest Home for Adults and $5500 to the purchase of supplies and $34,500.00 to the furniture, fixtures, furnishings, equipment, books, records, accounts, and all other items of

personal property used by Seller in the operation of the business known as or being conducted under the names of Castle Rest Nursing Home and Castle Rest Home for Adults."

2. Article 3 of the Agreement for Purchase and Sale of Business is hereby amended to read as follows:

"3. Terms

Purchaser agrees to pay the purchase price in cash on October 19, 1972, at which time the parties have agreed to hold said closing at the offices of Monroe Abstract and Title Corporation in the City of Syracuse, New York.

3. Article 6 of the Agreement for Purchase and Sale of Business is hereby amended to add a new Article D, as follows:

"D) Purchaser agrees to utilize the amounts received from the accounts receivable, cash transferred and other operating assets transferred to pay the accounts payable and accrued expense now a liability of Castle Rest Nursing Home and to hold such operating assets transferred in escrow until the payment of said operating liabilities above mentioned."

4. Article 7 of the Agreement for Purchase and Sale of Business is hereby amended to read as follows:

"7. Possession -

Possession shall be delivered to Purchaser at 11:00 P.M. October 19, 1972."

5. Article 8 of the Agreement for Purchase and Sale of Business is hereby amended as follows:

B) is amended to read,

"Seller is not required to comply with the New York State Uniform Commercial Code dealing with bulk transfer

of business, and Purchaser hereby agrees to assume and pay over any liability recorded or unrecorded which it may have with outside parties and which may assert liability against ~~Purchaser~~ Seller by reason of the failure to comply with the notice requirements of the New York State Uniform Commercial Code dealing with the bulk transfer of business, except that this provision shall not apply to any claims of Thomas M. Fahey, Jefferson-Franklin Corporation and Nicholas A. Courtessis.

6. Paragraph F) is hereby deleted.

7. Articles 9 and 10 of the Agreement for Purchase and Sale of Business are hereby deleted and a new Article 9 is hereby inserted, as follows:

"9. Continuation of the Management and Ownership of the Business -

In order to terminate and conclude any and all arbitration proceedings between the parties and any litigation or appeals from such litigation between the parties it is hereby expressly stipulated and agreed that Thomas M. Fahey was and still is a partner of Castle Rest Nursing Home and Castle Rest Home for Adults but is entitled to no further payments of salary, expenses, capital account, distributions, or other payments arising out of the operation of the business during any prior period, or arising out of any receipts from this transaction or for any other reason whatsoever, and if requested by the party of the first part will render and submit to the party of the first part a general release dated October 20, 1972."

8. Articles 1 and 3 of the Agreement of Exchange of Realty are hereby deleted and the following Article 1. is hereby substituted in their place and stead:

"1. Sale of Realty -

Party of the first part hereby agrees to sell, grant and release unto the party of the second part all that certain plot, piece or parcel of land, with the buildings and improvements thereon erected, situate, lying and being in the City of Syracuse, State of New York, being part of Lots 1, 10 and 11 Block 1013 in said City, bounded and described as follows:

BEGINNING at the intersection of the westerly line of South State Street with the southerly line of East Castle Street; running thence from the above mentioned point of beginning South 19° 46' 50" East along the westerly line of South State Street 264.0 feet; thence South 70° 53' 20' West 233.53 feet; thence North 19° 39' 10" West 44.0 feet; thence South 70° 53' 20" West 44.06 feet; thence North 19° 39' 10" West 88.0 feet; thence South 70° 53' 20" West 20.0 feet; thence North 19° 39' 10" West 132.0 feet to the southerly line of East Castle Street; thence North 70° 53' 20" East along the southerly line of East Castle Street 297.0 feet to the place of beginning.

Subject to right of way and easement granted by 116 East Castle Corporation to Bela Sternberg and Clara Sternberg dated Aug. 15, 1966 and recorded August 21, 1967 in the Onondaga County Clerk's Office in Liber 2350 of Deeds, page 205.; and those lots or parcels of land with the buildings and improvements thereon erected, situate, lying and being in the City of Syracuse, State of New York and known as Nos. 1428 through 1440, South State Street, in consideration of One Million and One Hundred and Seventeen Thousand ($1,117,000.00) Dollars, subject to mortgage being serviced by the Marine-Midland Bank - Central and other indebtedness not exceeding the sum of Six Hundred and Fifty Thousand ($650,000.00) Dollars. Any mortgage indebtedness

or other indebtedness under the aggregate amount of $650,000 at the date of the closing shall require an increase in the cash consideration set forth above."

EXECUTED by the parties hereto on the 19th day of October, 1972.

CASTLE REST NURSING HOME

By Walker McKinney
WALKER McKINNEY, Partner

By Jane W. McKinney
JANE W. McKINNEY, Partner

CASTLE REST FACILITIES CORPORATION

By Thomas M. Fahey
THOMAS M. FAHEY, President

Thomas M. Fahey
THOMAS M. FAHEY, Individually

[redacted]

(Settlement and Financing Papers — Group E) *
Exhibit E-10 — Mortgage Commitment Letter from Rochester Savings Bank (7/28/72).

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Rochester Savings Bank
40 Franklin Street-Rochester, New York 14604-716 263 4436

Frank A Brodt
Vice President
Treasurer & Mortgage Officer

7/28/72

July 28, 1972

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Castle Rest Realty Corp.
415 Stratford Street
Syracuse, New York

Attention: Mr. Thomas M. Fahey

Re: Castle Rest Nursing Home
Syracuse, New York

Gentlemen:

Rochester Savings Bank, herein called "Lender," agrees with Castle Rest Realty Corp., herein called "Borrower," to make the mortgage loan as hereinafter set forth, and Borrower agrees to borrow the proceeds of the mortgage loan in accordance with the following terms and conditions:

1. Premises to be mortgaged: the mortgage loan shall be a first lien on premises of Borrower located at 116 East Castle Street, east of South Salina Street and four blocks west of Route NY 81 South, in the City of Syracuse, County of Onondaga, New York, together with an existing 165-bed nursing home 4-1/2 stories in height, which brick and masonry building is presently situate on said premises. This facility contains laboratory, pharmacy and therapy rooms, together with offices and related appurtenances, with parking facilities and landscaping, all in accordance with information given and used by Pomeroy Appraisal Associates, Inc., in their appraisal of the value of said premises. Mortgaged premises shall also include all furniture, fixtures, equipment and replacements thereof owned by Borrower or Borrower's tenant, should there be a lease or operating agreement. A UCC financing statement shall be given by Borrower and/or its tenant to assure a first lien on such equipment and personal property.

2. Loan amount and terms of payment: Borrower's note shall be executed in the sum of Two Million Two Hundred Thousand Dollars ($2,200,000.00), with interest at the rate of nine and one-eighth percent (9-1/8%) per annum, to be

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Castle Rest Realty Corp. II July 28, 1972

amortized at a constant of 9.91% computed for a 28-year period but shall be due and payable twenty (20) years from the commencement of the mortgage term. Said note shall provide for payments as follows: Eighteen Thousand One Hundred Sixty-Eight Dollars ($18,168.00) on the first day of the month following the first full month subsequent to the closing of this mortgage loan, and $18,168.00 on the first day of each month thereafter, to be applied first to interest on the declining principal balance at the rate of nine and one-eighth percent (9-1/8%) per annum and the balance to principal for a term of twenty (20) years, at which time the entire unpaid principal balance shall become due and payable with interest. After the fifth (5th) loan year, principal may be prepaid in whole or in part, with a prepayment penalty based on the amount so prepaid, computed as follows: five percent (5%) if prepaid during the sixth year of the mortgage term, with penalty declining at the rate of one-half of one percent each year until the penalty shall be reduced to one percent (1%), which penalty shall then remain effective for the remainder of the mortgage term. Any partial prepayment of principal shall be in multiples of One Thousand Dollars ($1,000.00) and Lender shall not be obliged to accept prepayment unless it shall have received at least thirty (30) days' prior written notice of any intended prepayment. In the event of threatened default in the covenants and conditions of the mortgage, Lender may at its option require payment into a non-interest bearing escrow account of monthly installments sufficient to pay taxes and insurance premiums as they become due.

3. Should Borrower lease all or part of the premises, or enter into a management agreement, for purposes of operation, such documents will be subject to Lender's approval and shall be assigned to Lender as collateral security for the loan.

4. Security for the note shall be evidenced by a first mortgage executed in form satisfactory to Lender and its attorneys, and shall contain such covenants and conditions as are usually incorporated in mortgage forms of Lender not inconsistent with this agreement. The mortgage

shall also contain additional covenants and conditions substantially in accordance with the following:

(a) Borrower shall maintain proper records and accounts showing income and expenses in operation of the premises, and within ninety (90) days after the close of each fiscal year, Borrower shall submit profit and loss statement for previous fiscal year. Statements shall be prepared by an independent certified public accountant or by financial officers of Borrower satisfactory to Lender and shall be prepared in accordance with generally accepted accounting principles.

(b) Borrower shall pay a charge of four percent (4%) for each One Dollar ($1.00) of each monthly payment if not made within fifteen days after the due date to cover the extra expenses involved in handling delinquent payments.

(c) The transfer of title to the mortgaged property or the transfer of more than twenty percent (20%) of the stock of Mortgagor Corporation shall be subject to the approval of Lender, which approval shall not be unreasonably withheld, providing Lender does not conclude that such transfer would jeopardize the security of its mortgage loan.

(d) The Lender or its agent may make annual inspections of the premises.

(e) In the event the right or license to operate the facilities as a nursing home is terminated or suspended by the State of New York or other authority and not reissued within thirty (30) days from the date thereof the mortgage loan, at the option of Lender, may immediately become due and payable.

5. Other conditions: Lender will require as conditions to its acceptance of the mortgage loan:

(a) Application fee of Two Hundred Dollars ($200.00). Lender hereby acknowledges receipt of this fee.

(Settlement and Financing Papers — Group E) *
Exhibit E-10 — Mortgage Commitment Letter from Rochester Savings Bank (7/28/72).

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(b) Prior to closing, a certificate of occupancy or other appropriate evidence shall be obtained from local municipal authority showing that mortgaged premises are in accordance with relevant ordinances, regulations or statutes.

(c) Borrower shall furnish mortgagee policy of title insurance in form satisfactory to attorneys for Lender, together with instrument survey showing all improvements on the premises dated not later than thirty (30) days before closing of amortized loan and otherwise in form satisfactory to Lender's attorneys, together with such other instruments, resolutions, certificates and documents as may be reasonably required by Lender's attorneys. Borrower will also deliver to Lender's attorneys an opinion of Borrower's counsel in form and substance satisfactory to Lender's counsel to the effect that Borrower is a duly organized corporation under the laws of New York State in good standing and possesses power to operate premises in the manner set forth in the application for the mortgage loan and that the note, mortgage and other instruments have been duly executed and delivered and constitute valid and enforceable obligations of Borrower, and that no actions or proceedings are pending or threatened which would affect the validity of any instrument to be delivered in conjunction with the mortgage loan, and that counsel has no knowledge or information as to liens or other encumbrances which may have been filed or can be enforced against the premises to be mortgaged in connection with the construction of buildings or the improvements thereon.

(d) The form and content of all instruments to be executed by Borrower shall be subject to Lender's approval and that of Lender's counsel.

(e) Borrower shall furnish fire insurance with extended coverage for full insurable value but excluding items which normally would not be damaged by fire or other causes. Borrower will also provide and maintain appropriate liability insurance and other insurance coverage reasonably required by Lender, including Business Interruption Insurance to provide for income for a twelve (12) month period if operation of premises is terminated by casualty.

(Settlement and Financing Papers — Group E) *
Exhibit E-10 — Mortgage Commitment Letter from Rochester Savings Bank (7/28/72).

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Castle Rest Realty Corp. V July 28, 1972

(f) Mortgage loan on premises in accordance with the foregoing shall be consummated with Lender not later than October 31, 1972 unless time for delivery has been extended by Lender in writing. Lender may not be required to accept delivery of the loan before October 31, 1972 but may accept it at an earlier date at its option. Unless otherwise agreed upon, the loan shall be closed at the office of the Lender's attorneys, Harris, Beach and Wilcox, Two State Street, Rochester, New York.

(g) Borrower shall pay all expenses incurred in connection with mortgage loan, whether the loan is closed or not, including, without limitation, cost of title examination, premium for mortgagee title insurance policy, the cost of instrument survey, cost of any commission, brokerage or finder's fees or compensation, if any, in placing this loan, recording fees, mortgage tax and fees and disbursements of attorneys for Lender, and such other customary and reasonable expenses as are normally incurred in the area of the mortgaged premises in connection with closing of mortgage loans similar to that provided herein.

(h) This letter of agreement shall not be assigned by Borrower or pledged or hypothecated except with written consent of Lender.

(i) Prior to the closing of this mortgage loan and as a condition thereof, proof must be submitted to Lender that Thomas M. Fahey and Theodore G. Metzger are the owners of all of the stock of Borrower.

In the event the provisions herein contained are satisfactory to Borrower, this letter of commitment shall be accepted by Borrower not later than ten (10) days from the date of this letter. If not accepted within said period, this letter of commitment shall be deemed void and of no further force or effect. As evidence of Borrower's acceptance, the enclosed copy of this letter should be signed in the space indicated below and returned to Lender. Upon receipt of Borrower's acceptance, the terms and con-

(Settlement and Financing Papers — Group E) *
Exhibit E-10 — Mortgage Commitment Letter from Rochester Savings Bank (7/28/72).

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Castle Rest Realty Corp. VI July 28, 1972

ditions contained herein shall be binding and effective on both parties.

Very truly yours,

Frank A. Bradt

Frank A. Bradt

/bc
Enclosure

ACCEPTED AND APPROVED THIS 3rd DAY OF August, 1972.

CASTLE REST REALTY CORP.

By: Thomas M Farley
President

(Settlement and Financing Papers — Group E) *
Exhibit E-11 — Mortgage Note with Rochester Savings Bank (10/19/72).



MORTGAGE NOTE

$1,602,324.64 Dated: October 19, 1972

FOR VALUE RECEIVED, the undersigned, CASTLE REST FACILITIES CORPORATION, a New York corporation with offices located at 415 Stratford Street, Syracuse, New York, hereby promises to pay to ROCHESTER SAVINGS BANK, a banking corporation organized and existing under the laws of the State of New York, having its principal office at 40 Franklin Street, Rochester, New York, or its order, at 40 Franklin Street, Rochester, New York, 14604, or at such other place as may be designated in writing by the holder of this note, the principal sum of One Million Six Hundred Two Thousand Three Hundred Twenty-Four Dollars and Sixty-Four Cents ($1,602,324.64), with interest thereon to be computed from the date hereof at the rate of nine and one-eighth percent (9-1/8%) per annum, to be paid on the first day of March, 1973. It is hereby expressly agreed that the said principal sum secured by this note shall become due and payable at the option of the holder thereof on the happening of any default or event by which, under the terms of the mortgage securing this note, said principal sum may or shall become due and payable; also, that all of the covenants, conditions and agreements contained in said mortgage are hereby made a part of this instrument.

Presentment for payment, notice of dishonor, protest and notice of protest are hereby waived.

This note is secured by a mortgage made by the maker to the payee of even date herewith on property situate in the City of Syracuse, County of Onondaga, New York, known as 116 East Castle Street at the corner of South State Street, all as described in said mortgage.

This note may not be changed or terminated orally.

CASTLE REST FACILITIES CORPORATION

By: Thomas M Fahey
President

STATE OF NEW YORK)
) ss:
COUNTY OF ONONDAGA)

On this ____ day of _____, 1972, before me, the subscriber, personally appeared _____, to me known, who, being by me duly sworn, did depose and say that he resides at _____, New York, and is _____ of CASTLE REST FACILITIES CORPORATION, the corporation described in and which executed the foregoing instrument; that he knows the seal of said corporation; that the seal affixed to said instrument is such corporate seal; that it was so affixed by order of the Board of Directors of said corporation and that he signed his name thereto by like order.

_____
(Notary Public)

(Settlement and Financing Papers — Group E) *
Exhibit E-12 — Mortgage (first part) with Rochester Savings Bank (10/19/72).

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MORTGAGE

Made this [illegible] day of [illegible], 197[illegible], between CASTLE EAST FACILITIES CORPORATION, a New York corporation having an office at 415 Seaford Street, Syracuse, New York hereinafter called "Mortgagor," and Rochester Savings Bank, a banking corporation organized and existing under the laws of the State of New York, having its principal place of business at 40 Franklin Street, Rochester, New York, hereinafter called "Mortgagee",

WHEREAS, Mortgagor has executed and delivered to Mortgagee a certain promissory note of even date herewith in favor of Mortgagee and its assigns, in the principal sum of One Million Six Hundred Two Thousand Three Hundred Thirty-four and 64/100 Dollars ($1,602,334.64), with interest thereon at the rate therein specified, and payable in the manner and at the time therein set forth, and under the terms and conditions therein contained, all of which are incorporated herein by reference,

NOW THIS MORTGAGE WITNESSETH:

That in consideration of the aforesaid principal sum and as security for the payment thereof with interest as aforesaid, together with all other sums recoverable by Mortgagee under the terms of said note and of this mortgage, Mortgagor does hereby mortgage unto Mortgagee:

ALL THAT TRACT OR PARCEL OF LAND situate in the City of Syracuse, County of Onondaga and State of New York, being part of Lots 1, 10 and 11 Block [illegible] in said City, bounded and described as follows:

BEGINNING at the intersection of the westerly line of South State Street with the southerly line of East Castle Street; running

thence from the above mentioned point of beginning South 19° 46' 50" East along the westerly line of South State Street 264.0 feet;

thence South 70° 53' 20" West [illegible] feet;

thence North 19° 39' 10" West [illegible] feet;

thence South 70° 53' 20" West [illegible] feet;

thence North 19° 39' 10" West [illegible] feet;

thence South 70° 53' 20" West [illegible] feet;

thence North 19° 39' 10" West [illegible] feet to the southerly line of East Castle Street;

thence North 70° 53' 20" East along the southerly line of East Castle Street 297.0 feet to the place of beginning.

(Settlement and Financing Papers — Group E) *
Exhibit E-12 — Mortgage (first part) with Rochester Savings Bank (10/19/72).

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SUBJECT to a Right of Way and Easement, on, over and across the following described parcel of land:

ALL THAT TRACT OR PARCEL OF LAND situate in the City of Syracuse, County of Onondaga and State of New York being part of Block 1013 in said City, bounded and described as follows:

BEGINNING at a point on the westerly line of South State Street South 19° 46' 50" East 221.0 feet from the intersection of said westerly line of South State Street with the southerly line of East Castle Street, running

thence from the above mentioned point of beginning South 19° 46' 50" East along the westerly line of South State Street 16.0 feet;

thence South 70° 53' 20" West 183.50 feet;

thence North 19° 39' 10" West 9.65 feet;

thence North 81° 06' 40" West 30.56 feet;

thence South 70° 53' 20" West 59.99 feet;

thence South 35° 55' 46" West 8.72 feet to the southeasterly corner of a parcel of land conveyed by 116 East Castle Corporation to Bela & Clara Sternberg and recorded in Book of Deeds 2819 at page 57 &c., in the Onondaga County Clerk's Office on September 22, 1966;

thence North 19° 39' 10" West along the easterly line of said Sternberg 16.0 feet;

thence North 35° 55' 46" East 8.72 feet;

thence North 70° 53' 20" East 63.33 feet;

thence South 81° 06' 40" East 46.86 feet;

thence North 70° 53' 20" East 165.0 feet to the westerly line of South State Street and the place of beginning.

TOGETHER WITH all and singular the present and future buildings, additions and improvements, and any and all fixtures, appliances and equipment of any nature whatsoever owned by Mortgagor, now or hereafter installed in or upon said premises or used in connection with the premises or the operation of the plant or business situate thereon, streets, alleys, passages, ways, waters, water courses, rights, liberties, privileges, hereditaments and appurtenances whatsoever thereunto belonging or in any wise appertaining, and the reversions and remainders, rents, issues and profits thereof, now or hereafter accruing, but not including, however, trade fixtures, furniture and equipment, stock and other personal property, whether or not affixed to the mortgaged property owned by any tenant, sub-tenant or concessionaire of all or a portion of the mortgaged property.

TO HAVE AND TO HOLD said property hereby granted or mentioned and intended so to be, with the appurtenances (such property and appurtenances being herein referred to together as the "mortgaged property") unto Mortgagee and its assigns, all of which are subject to the lien of this mortgage.

(Settlement and Financing Papers — Group E) *
Exhibit E-12 — Mortgage (first part) with Rochester Savings Bank (10/19/72).

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1. Until the entire indebtedness secured by this mortgage, including all sums due Mortgagee under the terms of this mortgage and of the note, with interest, is fully paid, Mortgagor covenants and agrees:

(a) To pay when due and payable and before interest and penalties are due thereon all taxes, water and sewer rents, assessments and all other charges or claims which may be assessed or levied upon the mortgaged property at any time, by any lawful authority, and which by any present or future law may have priority over said indebtedness either in lien or in distribution out of the proceeds of any judicial sale, and to produce to Mortgagee on or before the last day upon which they may be paid without penalty or interest, receipts of the current year for the payment of all such taxes, water and sewer rents, assessments, charges and claims; provided that, if pursuant to this mortgage or otherwise Mortgagor shall have deposited with Mortgagee before the due date thereof sums sufficient to pay any such taxes, water and sewer rents, assessments, charges or claims, the same shall be paid by Mortgagee; that, notwithstanding any provisions of this mortgage so long as the validity of any taxes, assessments or other governmental charge or claim due, or to become due, is being contested by Mortgagor or by a tenant of the mortgaged property in good faith, the same need not be paid by Mortgagor, if such non-payment pending such contest will not place the mortgaged property in imminent danger of forfeiture or loss.

(b) To maintain insurance on the mortgaged property of such kinds, in such amounts and in such companies as are satisfactory to Mortgagee; and if said insurance or any part thereof shall expire, or be withdrawn, or become void by breach of any condition thereof by Mortgagor, or become void or unsafe by reason of the failure, or impairment of the capital of any company in which said insurance may then be, or if for any other reason whatsoever said insurance shall become unsatisfactory to Mortgagee, to effect new insurance on said mortgaged property satisfactory to Mortgagee; and to pay as they shall grow due all premiums for such insurance; and to lodge with Mortgagee, as further security for said indebtedness, all policies therefor, with loss payable clauses attached in favor of and acceptable to Mortgagee. In event of loss Mortgagor will give immediate notice by mail to Mortgagee, and Mortgagee may make proof of loss if not made promptly by Mortgagor. Mortgagor hereby directs any insurance company concerned to pay directly to Mortgagee any moneys which may become payable under such insurance, including return of unearned premiums, such moneys, or any part thereof, to be applied to the repair of the property damaged; and Mortgagor appoints Mortgagee as attorney in fact to endorse any draft therefor. In the event of foreclosure of this mortgage or other transfer of title to the mortgaged property in extinguishment of the indebtedness secured hereby, all right, title and interest of Mortgagor to any insurance policies then in force covering the mortgaged property shall pass to the transferee of the mortgaged property. Insurance proceeds recovered by the Mortgagee on account of damage or destruction to the premises and all proceeds of any condemnation award recovered for any building or equipment taken or damaged shall, upon the written request of Mortgagor, be held in trust by Mortgagee and paid in installments by Mortgagee for the cost of

(Settlement and Financing Papers — Group E) *
Exhibit E-12 — Mortgage (first part) with Rochester Savings Bank (10/19/72).

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repairing, restoring or rebuilding the premises so damaged or destroyed or of the portion or portions of the premises not so taken, such payments to be made as the work progresses. Such written request of Mortgagor shall be submitted to Mortgagee not later than thirty (30) days after the receipt by Mortgagee of such insurance proceeds or condemnation award. Should Mortgagor fail to make such written request within said 30-day period or should Mortgagor elect not to repair, restore or rebuild said premises, Mortgagee may apply such proceeds to the payment of the unpaid principal balance of said indebtedness, together with interest thereon to the date of payment, together with expenses incurred in so terminating the mortgage and mortgage note and any insurance proceeds or award in excess of the funds needed for this purpose shall forthwith be returned by Mortgagee to Mortgagor. The insurance above referred to shall include fire insurance with extended coverage, public liability insurance, rental or business interruption insurance which shall insure continued income from the premises during periods of repair, restoration or rebuilding after damage by fire or other causes, and such other insurance as Mortgagee may require. Such insurance may be in the form of a blanket policy or policies covering the buildings and equipment on the mortgaged property and other locations.

(c) To maintain the mortgaged property in good repair, order and condition; not to remove from the mortgaged property fixtures, appliances and equipment of any nature covered by the lien of this mortgage without having obtained the prior written consent of Mortgagee; and Mortgagor will not alter, demolish or make, install, or permit to be made or installed, any alterations, additions or improvements which affect the structural components of the mortgaged property and cost in excess of Fifty Thousand Dollars ($50,000.00) without obtaining the prior written consent of Mortgagee which consent Mortgagee hereby reserves the right to refuse to grant.

(d) To comply with all laws, ordinances, regulations and orders relating to the mortgaged property by all Federal, State, Municipal and other governmental authorities.

(e) To notify Mortgagee promptly upon receiving any notice of commencement of any proceedings for the condemnation of mortgaged property, and, subject to provisions in Paragraph (b) above, to permit Mortgagee to participate in such proceedings and to receive all proceeds payable to Mortgagor as an award or in settlement up to the amount of the unpaid principal, accrued interest and any other sums due hereunder.

(f) To furnish Mortgagee within ninety (90) days of the close of each fiscal year audited Profit and Loss statements prepared by independent certified public accountants or a financial officer in Mortgagor's business satisfactory to Mortgagee, in such detail as Mortgagee may reasonably require.

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(g) If Mortgagor or any successor or assignee of Mortgagor is a corporation, to keep in effect its existence and rights as a corporation and its right to own property and transact business in the State of New York; and to pay when due and payable and before interest and penalties are due thereon all corporation taxes owing by Mortgagor to the United States of America, the State of New York, and any political subdivision thereof and to produce to Mortgagee on or before September 1 of each year: (i) copies of all corporation tax returns filed during the previous twelve (12) months with the United States of America, the State of New York and any political subdivision thereof, and (ii) receipts evidencing the full payment of all amounts shown to be due on such returns, and within ten (10) days of receipt thereof all settlements, notices of deficiency or overassessment and any other notices pertaining to Mortgagor's tax liability, which may be issued by the United States of America, the State of New York and any political subdivision thereof.

(h) To pay to Mortgagee, if requested, on each installment due date an additional sum equal to one-twelfth of the annual taxes, assessments, water and sewer charges, if any, and premiums for fire insurance policies on the mortgaged property. If the fund so held by Mortgagee shall be insufficient to pay any of the aforesaid items when due, Mortgagor upon demand shall deposit with Mortgagee such additional funds as may be necessary to remove such deficiency. All the sums deposited with Mortgagee may be commingled with Mortgagee's general funds and shall be non-interest bearing. In the event title to the mortgaged property passes to another party, either voluntarily or by operation of law, all the right, title and interest of Mortgagor in the aforesaid fund shall pass to the new owner of the mortgaged property, or at the option of Mortgagee be used to reduce the mortgage debt. The above notwithstanding, Mortgagee hereby waives all monthly deposits for taxes, assessments, water and sewer charges and insurance premiums so long as there shall be no default under the loan documents and/or no defaults in the payments of said obligations which, if continued, would result in a lien upon mortgaged premises, a termination of utility services to the premises, or a cancellation of insurance coverage.

(i) To assign to Mortgagee as additional collateral security for the indebtedness secured by this mortgage all leases now in existence or hereafter granted affecting all or any part of said mortgaged premises, and to perform every obligation of the lessor and to enforce every obligation of the lessee in every lease that is assigned to Mortgagee or any tenancy in which the rents are assigned to Mortgagee, and not to modify, alter, waive or cancel any such lease or any part thereof, nor anticipate for more than one month any rents that may be collectible under such lease or that may have been assigned to Mortgagee nor assign any such lease or any such rents.

(j) If Mortgagee shall become a party, either as plaintiff or defendant, to any suit or legal proceeding affecting the lien hereby created on the mortgaged property, to pay to Mortgagee on demand its costs, expenses and reasonable attorneys' fees in such suit or proceeding, and

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Exhibit E-12 — Mortgage (first part) with Rochester Savings Bank (10/19/72).

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(k) In the event of default hereunder or under said Note, to pay to Mortgagee on demand all costs and expenses incurred by Mortgagee in connection with the curing of any such default or the collection of sums secured hereby, including but not limited to cost of any title search and reasonable attorneys' fees.

2. In the event Mortgagor should fail to pay said taxes, water and sewer rents, assessments, charges, claims, costs, expenses or fees or to maintain said insurance, or to make all necessary repairs to the mortgaged property, all as hereinbefore provided, Mortgagee may, at Mortgagee's sole option and without notice to Mortgagor, advance sums on behalf of Mortgagor in payment of said taxes, water and sewer rents, assessments, charges, claims, costs, expenses, fees, insurance and repairs, which repairs Mortgagor hereby authorizes Mortgagee to make, without prejudice to the right of enforcement of the obligation of the note, or the other remedies of Mortgagee as herein set forth, by reason of the failure of Mortgagor to make payment of the same; and all such sums so advanced by Mortgagee shall be added to and become a part of the indebtedness secured hereby, and repayment thereof, with interest thereon at the rate of ten percent (10%) per annum if the Mortgagor is a corporation, otherwise at the rate of six percent (6%) per annum, from the dates of their respective expenditures, may be enforced by Mortgagee against Mortgagor at any time.

3. When said principal sum or any unpaid balance thereof shall become due and payable, or in case default shall be made in the payment of any installment of principal and/or interest on the date on which it shall fall due in accordance with the provisions of said note, or in the performance of any of the terms, agreements or covenants contained in said note or in this mortgage, then Mortgagee may forthwith and without further delay:

(a) institute an action of mortgage foreclosure against the mortgaged property, or take such other action at law or in equity for the enforcement hereof and realization on the within mortgage security as the law may allow, and may proceed thereon to final judgment and execution thereon for the entire unpaid balance of said principal sum, with interest at the rate stipulated in said note to the date of default, and thereafter at the rate of ten percent (10%) per annum if Mortgagor is a corporation, otherwise at the rate of six percent (6%) per annum, together with all other sums due by Mortgagor in accordance with the provisions hereof and of said note, including all sums which may have been loaned by Mortgagee to Mortgagor after the date of this mortgage, and all sums which may have been advanced by Mortgagee for taxes, water or sewer rents, charges or claims, insurance, or repairs to the mortgaged property, all costs of suit, together with interest at six percent (6%) per annum on any judgment obtained by Mortgagee from and after the date of any Sheriff's Sale until actual payment is made by the Sheriff of the full amount due Mortgagee, and an attorneys' commission for collection which shall be five percent (5%) of the total of the foregoing sums, but not less than $200.00, without further stay, any law, usage or custom to the contrary notwithstanding; and/or

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Exhibit E-12 — Mortgage (first part) with Rochester Savings Bank (10/19/72).

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(b) enter into possession of the mortgaged property, with or without legal action, and by force if necessary; collect all rentals or income therefrom and, after deducting all costs of collection and administration expense, apply the net rentals or income to the payment of taxes, water and sewer rents, charges and claims, insurance premiums and all other carrying charges, and to the maintenance, repair or restoration of the mortgaged property, or on account and in reduction of the principal and/or interest hereby secured, in such order and amounts as Mortgagee, in Mortgagee's sole discretion, may elect; and for said purpose Mortgagor hereby assigns to Mortgagee all rentals or income due and to become due under any lease or leases or in the operation of the mortgaged property whether now existing or hereafter created, as well as all rights and remedies provided in such lease or leases for the collection of said rents; and Mortgagor hereby authorizes and empowers any attorney or attorneys of any court of the State of New York or elsewhere to appear for Mortgagor and as attorney for Mortgagor to sign an agreement for entering an amicable action of ejectment for possession of the mortgaged property, and to confess judgment therein against Mortgagor in favor of Mortgagee, whereupon a writ of possession may immediately issue for the possession of the mortgaged property, without any prior writ or proceeding whatsoever; and for so doing this mortgage or a copy hereof verified by an affidavit shall be a sufficient warrant. Mortgagee may bring such amicable action in ejectment before or after the institution of foreclosure proceedings upon this mortgage, or after judgment thereon or on said note, or after a Sheriff's Sale of the mortgaged property.

(c) Mortgagee shall not declare the principal sum due and payable unless and until (i) default shall be made in the payment of any installment of principal or interest on the note which this mortgage secures or in the payment of any tax assessment, sewer rent or water charge then delinquent and such default shall continue for a period of ten (10) days after written notice thereof from Mortgagee to Mortgagor, or (ii) if default shall be made by Mortgagor in the performance or compliance with any of the provisions of this mortgage other than those referred to in (i) above and such default shall continue for a period of thirty (30) days after written notice thereof from Mortgagee to Mortgagor, or in case of a default that cannot be cured with due diligence within such period of 30 days Mortgagor fails to proceed promptly and with due diligence to cure the same within a reasonable time.

4. The remedies of Mortgagee as provided herein, or in said note, and all warranties herein and in said note contained shall be cumulative and concurrent, and may be pursued singly, successively, or together against Mortgagor and/or the mortgaged property at the sole discretion of Mortgagee, and such warranties shall not be exhausted by any exercise thereof but may be exercised as often as occasion therefor shall occur; and the failure to exercise any such right or remedy shall in no event be construed as a waiver or release of the same.

5. Mortgagor hereby waives and releases all errors, defects, and imperfections in any proceedings instituted by Mortgagee under this mortgage, as well as all benefit that might accrue to Mortgagor by virtue of any present or future laws

(Settlement and Financing Papers — Group E) *
Exhibit E-12 — Mortgage (first part) with Rochester Savings Bank (10/19/72).

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exempting the mortgaged property, or any part of the proceeds arising from any sale thereof, from attachment, levy or sale under execution, or providing for any stay of execution, exemption from civil process, or extension of time for payment.

6. If Mortgagor pays to Mortgagee said principal sum and all other sums payable by Mortgagor to Mortgagee as are hereby secured, in accordance with the provisions of said note and in the manner and at the times therein set forth, without deduction, fraud, or delay, then and from thenceforth this mortgage, and the estate hereby granted, shall cease and become void, anything herein contained to the contrary notwithstanding.

7. The words "Mortgagor" and "Mortgagee" whenever occurring her in shall be deemed and construed to include the respective heirs, personal representatives, successors and assigns of Mortgagor and Mortgagee; and if there shall be more than one Mortgagor, the obligation of each shall be joint and several. This mortgage shall be governed by and construed according to the laws of the State of New York.

8. Any tenant of Mortgagor shall have and may exercise all rights and privileges of such tenant under its lease and such exercise and enjoyment shall not constitute a default under this mortgage, and for all purposes of this mortgage performance or compliance by any tenant of Mortgagor with any act or obligation of Mortgagor shall be the equivalent of Mortgagor's performance thereof or compliance therewith.

9. That whether or not such is specifically provided in any particular case in this mortgage where any of the terms or provisions of this mortgage require the approval, satisfaction or consent of Mortgagee, such approval, satisfaction or consent shall not be unreasonably withheld or delayed by Mortgagee.

10. Should Mortgagor transfer title to mortgaged premises or any part thereof, or should there be a transfer of stock in Mortgagor Corporation which would result in transfer in control of management of the mortgaged premises to other than the present principals of Mortgagor, without first obtaining the written consent of Mortgagee to each such conveyance, Mortgagee shall have the option to declare the whole of the unpaid principal sum, with interest thereon, due and payable. In exercising such option, Mortgagee shall serve thirty (30) days' prior written notice in person or by registered mail on Mortgagor.

11. Mortgagor warrants title to the mortgaged premises.

12. Mortgagor shall maintain, or cause to be maintained, throughout the term of this mortgage a license or permit required by the State of New York or other authority to operate mortgaged property as a nursing home and any termination, suspension, cancellation or inability to renew such license shall constitute a default hereunder.

13. Mortgagee or its agent may make annual inspections of mortgaged premises.

14. Mortgagor, in compliance with Section 13 of the Lien Law will receive the principal indebtedness secured by this

(Settlement and Financing Papers — Group E) *
Exhibit E-12 — Mortgage (first part) with Rochester Savings Bank (10/19/72).

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mortgage and hold the right to receive such funds as a trust fund to be applied first for paying the costs of materials or improvements if any before using any part of the total of this indebtedness for any other purpose.

IN WITNESS WHEREOF, the Mortgagor has duly executed this mortgage as of the day and year first above written.

CASTLE REST FACILITIES CORPORATION

By: _____
Thomas M. [illegible]

ONONDAGA COUNTY
MORTGAGE TAX $ 8011.50
NET ADDITIONAL TAX $ 4005.75
TOTAL MTG TAX PAID: 12,017.25

(Settlement and Financing Papers — Group E) *
Exhibit E-12 — Mortgage (first part) with Rochester Savings Bank (10/19/72).

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Liber 2491 Page 265

STATE OF NEW YORK)
) ss:
COUNTY OF Onondaga)

On this 19th day of October, 1972, before me personally appeared Thomas M. Fahey, to me known, who being by me duly sworn, did depose and say that he resides in Syracuse, New York; that he is the President of CASTLE REST FACILITIES CORPORATION, the corporation described in and which executed the within instrument; that he knows the seal of said corporation; that the seal affixed to said instrument is such corporate seal; that it was so affixed by order of the Board of Directors of said corporation, and that he signed his name thereto by like order.

Ralph J. Balducci
(Notary Public)

RALPH J. BALDUCCI
Notary Public in the State of New York
Qualified in Madison Co. No. 53[illegible]
My Commission Expires March 30, 19 74

Consolidated with Mtge. of 10/19/72 - Liber 2491 - Page 265 - 4/10/73 - 4:15 p.m.

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Exhibit E-12 — Mortgage (first part) with Rochester Savings Bank (10/19/72).

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2481 [illegible]

COLUMBIA COUNTY CLERK'S OFFICE
Mortgage Recorded on the
[illegible] day of [illegible] 19[illegible]
Liber 2481 of Book [illegible] Page 277
and Examined.
Calvin D. Hamilton, Clerk

17 ow/my

Consolidated as pt 1 unit of Realty Book 2481 pages 406 416

Oct 19 11 [illegible]
[illegible] 43 Mortgages

(Settlement and Financing Papers — Group E) *
Exhibit E-13 — Mortgage (second part) with Rochester Savings Bank (10/19/72).

RJM:DC:5:10/16/72

LTO

E-13

CONSOLIDATION AND EXTENSION AGREEMENT

Made this 19th day of October, 1972, by and between ROCHESTER SAVINGS BANK, a banking corporation organized and existing under the laws of the State of New York, having its principal office at 40 Franklin Street, Rochester, New York, First Party, and CASTLE REST FACILITIES CORPORATION, a New York corporation with offices located at 415 Stratford Street, Syracuse, New York, Second Party,

W I T N E S S E T H :

WHEREAS, First Party is the owner and holder of a certain mortgage made by 116 East Castle Corporation to Marine Midland Bank - Central (formerly Marine Midland Trust Company of Central New York), which mortgage was in the original sum of Seven Hundred Fifty Thousand Dollars, dated and recorded on September 22, 1966 in the Office of the Clerk of the County of Onondaga in Liber 2334 of Mortgages at Page 293; said mortgage was assigned to First Party by Marine Midland Bank - Central by assignment of mortgage of even date herewith, together with the note of even date therewith which said mortgage secured, upon which there is now unpaid the principal sum of Five Hundred Ninety-Seven Thousand Six Hundred Seventy-Five Dollars and Thirty-Six Cents ($597,675.36), which mortgage is now a lien on premises situate in the City of Syracuse, Onondaga County, New York, on premises located at the southwest corner of East Castle Street and South State Street, as more particularly described in said mortgage, and

WHEREAS, First Party is also the owner and holder of another mortgage made by Second Party in the sum of One Million Six Hundred Two Thousand Three Hundred Twenty-Four Dollars and Sixty-Four Cents ($1,602,324.64) dated October 19, 1972 and recorded in Onondaga County Clerk's Office, which mortgage is also now a lien on said premises and was given to secure a note of even date therewith, upon which is now unpaid the principal sum of One Million Six Hundred Two Thousand Three Hundred Twenty-Four Dollars and Sixty-Four Cents ($1,602,324.64), and

WHEREAS, Second Party is now the owner in fee simple of the premises covered by the said mortgages, and

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Exhibit E-13 — Mortgage (second part) with Rochester Savings Bank (10/19/72).

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WHEREAS, the parties hereto desire to combine, consolidate and make equal and coordinate said liens on the premises hereinbefore described so that they shall form a single, coordinate, equal lien on the said premises of Two Million Two Hundred Thousand Dollars ($2,200,000.00), with interest,

NOW, THEREFORE, in consideration of the sum of One Dollar ($1.00) to each in hand paid, the receipt of which is hereby acknowledged, and for other good and valuable consideration, it is hereby mutually covenanted and agreed by and between the parties hereto that the said mortgages be and the same hereby are combined, consolidated and made equal and coordinate liens on the premises hereinbefore mentioned, without priority of one over the other, so that together they shall constitute in law but one first mortgage, and

WHEREAS, Second Party desires to have the terms of payment of the said sum of Two Million Two Hundred Thousand Dollars ($2,200,000.00) and interest thereon modified and extended, and First Party is agreeable thereto on the conditions hereinafter set forth,

NOW, THEREFORE, for good and valuable consideration, the receipt of which is hereby acknowledged, First Party hereby extends the payment of the outstanding balance of said principal indebtedness secured by said notes in the sum of $2,200,000.00, and Second Party hereby covenants to pay to First Party said principal sum and interest thereon in the manner following:

Six Thousand Six Hundred Ninety-One Dollars and Sixty-Eight Cents ($6,691.68) on the first day of November, 1972; Eighteen Thousand One Hundred Sixty-Eight Dollars ($18,168.00) on the first day of December, 1972; and $18,168.00 on the first day of each month in each year thereafter, to be applied first on interest at the rate of nine and one-eighth percent (9-1/8%) per annum and the balance on principal until the first day of October, 1992, at which time the entire unpaid principal balance shall become due and payable with interest. After the fifth (5th) year of the term above defined, principal may be prepaid in whole or in part, with a prepayment penalty based on the amount so prepaid computed as follows: five percent (5%) if prepaid during the sixth (6th) year of the mortgage term, four and one-half percent (4-1/2%) if prepaid during the seventh (7th) year, with the amount of such penalty declining at the rate of one-half of one percent each year until the penalty shall be reduced to one percent, which penalty shall then remain effective for the remainder of the mortgage term. Any partial prepayment of principal shall be in multiples of One Thousand Dollars ($1,000.00), and First Party shall not be obliged to accept prepayment unless it shall have received at least thirty (30) days'

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prior written notice of any intended prepayment.

In the event any payment herein shall remain unpaid in excess of fifteen (15) days, First Party herein may at its option collect late charge not to exceed four percent (4%) of said payment to cover its extra handling expense.

IT IS FURTHER MUTUALLY AGREED that the provisions, conditions, covenants and agreements contained in said note and mortgage in the sum of One Million Six Hundred Two Thousand Three Hundred Twenty-Four Dollars and Sixty-Four Cents ($1,602,324.64) dated October 19, 1972 shall be effective as to the whole indebtedness of $2,200,000.00 in the same manner and to the same effect as if said covenants had been originally included in all of the respective notes and mortgages herein mentioned, except as modified and extended by this agreement, and nothing herein contained shall waive, annul, vary or affect the rights or remedies of First Party except for the terms of payment herein set forth.

This agreement shall bind the successors and assigns of the parties hereto.

IN WITNESS WHEREOF, the parties hereto have caused their corporate seals to be hereunto affixed and these presents to be signed by their duly authorized officers the day and year first above written.

ROCHESTER SAVINGS BANK

By: _____
AVP

CASTLE REST FACILITIES CORPORATION

By: _____
Thomas M. Fahey, Pres.

(Settlement and Financing Papers — Group E) *
Exhibit E-13 — Mortgage (second part) with Rochester Savings Bank (10/19/72).

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STATE OF NEW YORK)
) ss:
COUNTY OF MONROE)

On this 18 day of October, 1972, before me, the subscriber, personally appeared Dexter O Harris, to me known, who, being by me duly sworn, did depose and say that he resides 170 Crescent Dr, Rochester, New York, and is Asst VP of ROCHESTER SAVINGS BANK, the corporation described in and which executed the foregoing instrument; that he knows the seal of said corporation; that the seal affixed to said instrument is such corporate seal; that it was so affixed by order of the Board of Trustees of said corporation and that he signed his name thereto by like order.

(Notary Public)
LE ROY LAWRENCE
Notary Public in the State of New York
MONROE COUNTY, N. Y.
Commission Expires March 30, 1974

STATE OF NEW YORK)
) ss:
COUNTY OF ONONDAGA)

On this 19th day of October, 1972, before me, the subscriber, personally appeared Thomas M. Fahey, to me known, who, being by me duly sworn, did depose and say that he resides Syracuse, New York, and is President of CASTLE REST FACILITIES CORPORATION, the corporation described in and which executed the foregoing instrument; that he knows the seal of said corporation; that the seal affixed to said instrument is such corporate seal; that it was so affixed by order of the Board of Directors of said corporation and that he signed his name thereto by like order.

JOSEPH J. SALDUCCI
Notary Public in the State of New York
Qualified in Madison Co. Pro. Clerk's
Commission Expires March 30, 1974

R 3344 - 293
R 1451 - 391

Recd. Onondaga County Clerk's Office
19 Oct 72
Sidney C. Mitchell, County Clerk

(Book 2354, page 484) (Book 2481, page 397 rec)

(Settlement and Financing Papers — Group E) *
Exhibit E-14 — Lease of Real Property to Thomas Fahey
from Castle Rest Facilities Corp. (10/19/72).

Exh E-14

LEASE

THIS LEASE AGREEMENT, made and entered into at Syracuse, New York, County of Onondage, State of New York, on this 18th day of October, 1972 by and between Castle Rest Facilities Corporation, hereinafter referred to as "LESSOR", whose address is Syracuse, New York, and Castle Rest Nursing Home, hereinafter referred to as "LESSEE", whose address is 116 East Castle Street, Syracuse, New York.

The terms "LESSOR" and "LESSEE" being intended to include the successors and assigns of the original parties and the heirs, legal representatives, successors and assigns of the respective persons who from time to time are Lessor and Lessee, wherever the context of this Lease so requires or admits.

W I T N E S S E T H:

1. DEMISE OF PREMISES:

That the LESSOR, for and in consideration of the rents herein reserved to be paid by the LESSEE, and for and in consideration of the covenants to be kept and performed by the LESSEE, does hereby lease, let and demise unto the LESSEE, the following described premises, situated in the City of Syracuse, County of Onondaga, State of New York, commonly known as 116 East Castle Street, and legally described as follows:

See annexed description,
Exhibit "A"

The above described premises includes all buildings, structures and other improvements constructed and to be constructed thereon, and all easements, rights and appurtenances thereto.

2. DURATION OF TERM:

The term and duration of the Lease shall be for a period of twenty (20) years, commencing with the commencement date herein provided and continuing from said commencement date to the end of the term.

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Secondary Term: (Option to Renew)

Upon the expiration of the primary term of this Lease, the LESSEE shall have two (2) successive options to renew for five (5) years' duration for each option, providing that it shall give the LESSOR notice in writing at least ninety (90) days prior to the expiration of the primary term of this Lease that it intends to renew same, and likewise ninety (90) days notice prior to the expiration of the first five (5) year extended term that it intends to renew same. The extended terms hereunder shall be subject to all of the terms and conditions of the within Lease. The rental for the extended terms hereof shall be the same as the primary term, payable monthly in advance in monthly installments.

3. COMMENCEMENT DATE:

The commencement date shall be that date which is the first day of the month following the date when LESSEE shall have been put into physical possession of the premises, to wit, November 1, 1972.

4. AMOUNT OF RENT AND MANNER OF PAYMENT:

LEASE DATED OCTOBER 18, 1972
(AMENDED PARAGRAPH NO. 4)

4. AMOUNT OF RENT AND MANNER OF PAYMENT:

A) The total rent for the Primary Term of Twenty (20) years shall be SIX MILLION TWO HUNDRED SIXTEEN THOUSAND & 00/100 ($6,216,000.00) Dollars, said sum being equal to an annual rental of THREE HUNDRED TEN THOUSAND EIGHT HUNDRED & 00/100 ($310,800.00) Dollars, which sum shall be payable in equal monthly installments of TWENTY-FIVE THOUSAND NINE HUNDRED AND 00/100 ($25,900.00) Dollars, payable monthly in advance, at LESSOR'S address set forth above, commencing on the commencement date, and payable monthly thereafter on the first day of each and every calendar month during the term of this Lease and any extension thereof. In the event that the term commences other than on the first day of the month, rent for the first and last months of the term shall be prorated.

B) In addition to the payments required herein as rent to the LESSOR, the LESSEE shall also pay the following:

OVE, BALDUCCI
AND
SCACCIA
TORNEYS AT LAW
SYRACUSE, N. Y.

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(1) All Occupational Licenses, and other licenses necessary in the operation of the business to be carried on in the demised premises.

(2) All utility services provided to the premises, including but not limited to water, gas, electric, and telephone, as they from time to time shall accrue and be due and payable during the term of this Lease.

(3) LESSEE shall pay to the appropriate municipal agencies ad valorem taxes and special assessments with respect to the demised premises and the improvements thereon during the term of this Lease or any extension thereof. It is further understood and agreed that all ad valorem taxes assessed during the first and last years of the term of this Lease shall be prorated and that LESSEE shall only be liable for such portions of such taxes assessed for said first and last years as its months of occupancy during any of said years shall bear to the total of twelve (12) months. In the event of the imposition of any special assessment or assessments which may be paid in annual installments, at LESSEE's option exercisable by written notice to LESSOR, LESSOR shall advise the appropriate municipal agency of its intention to elect payment in annual installments and LESSEE shall be liable for only such annual installments as shall be due and payable during the term of this lease or, if the option to extend shall be exercised, the extended term hereof. Should LESSEE fail to pay any tax or special assessment when due and payable, LESSOR may, if LESSOR so desires, pay the same and the amount together with any penalties which LESSOR may have paid, shall immediately become due and payable to LESSOR as additional rent. LESSEE shall have the right in its name or in LESSOR'S name, whichever shall be appropriate, but at its own cost and expense, to file and prosecute applications for reduction of assessed valuation and to institute legal proceedings for the reduction thereof.

C) LESSEE shall not pay any income, franchise, or excess profits tax levied upon or assessed against the LESSOR.

5. COVENANTS OF THE LESSEE:

The LESSEE hereby covenants and agrees with LESSOR as follows:

A) That it will pay the rent as herein specified without notice.

B) That it will keep the demised premises and the improvements placed thereon in a good state of repair, and it will be responsible for all repairs, including painting the interior and exterior

of the building, maintaining the roof of the building, all windows, doors and openings, all electrical, heating, plumbing, air conditioning, elevators and other systems installed within the building, paved parking area, shrubbery, planting, flood lights, and all other accessories, appurtenances and related equipment.

C) That it will, during the full term of this Lease, and any extensions thereof, and at its own expense, carry:

(1) Comprehensive general liability insurance naming LESSOR as insured in minimum limits of $100,000 each person, $300,000 each accident and $25,000 property damage. The policies shall cover accident or damage in or on the demised premises, sidewalk in front thereof, parking area, entrance ways, and all other portions of the building thereon.

(2) Fire insurance, with extended coverage, in an amount equal to the full replacement cost of the building on the demised premises, naming LESSOR as the insured. Such policy may also have a mortgagee clause in favor of any mortgagee on the demised premises to whose mortgage this lease shall be subordinate as hereinafter provided. Such insurance policy may also contain, at LESSEE'S option, a waiver of subrogation provision. Upon the failure of the LESSEE to furnish any policy of insurance as above set forth, LESSOR may, at its option, obtain the same and the premium therefor shall immediately become due and payable as additional rent.

(3) Business interruption insurance to provide for income for a twelve (12) month period if operation of premises is terminated by casualty. The minimum amount of such insurance coverage shall be equal to annual carrying charge for taxes, and insurance and also interest and principal payable on any mortgages secured by demised premises.

D) That, at the expiration of said term or any extension or renewal thereof, it will quit and surrender the demised premises in a good and substantial state of repair, reasonable wear and tear and damage by fire or the elements, or from other causes beyond its control, excepted.

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E) That it will comply with all lawful requirements of the Board of Health, Police Department, Fire Department, Municipal, State and Federal authorities respecting the manner in which it uses the leased premises.

6. COVENANTS OF THE LESSOR:

The LESSOR hereby warrents, represents and covenants to the LESSEE as follows:

A) TITLE:
That LESSOR has the full right to lease the property herein above described for the term aforesaid.

B) QUIET ENJOYMENT:
That, upon LESSEE paying the rent and observing and performing all of the terms, covenants and conditions on LESSEE'S part to be observed and performed, that LESSEE may peaceably and quietly have, hold, occupy and enjoy the demised premises and all the appurtenances thereto without hindrances or molestation; provided, however, that LESSOR and LESSOR'S agents may examine the leased premises at any reasonable time.

C) UTILITY LINES:
That water lines, sewer lines, electric lines, gas lines, and telephone lines are installed and are available for the facilities constructed on the subject property.

D) PAYMENTS:
That, in the event the LESSOR shall fail to make the payments on any mortgages, or taxes or other payments on the demised premises which LESSOR is required to pay, the LESSEE may, but shall not be required to, make such mortgage or tax payments or such other payments or do such acts and things as may be necessary to keep the mortgages or taxes on the premises from being in default, and may deduct the expense and cost thereof from the next ensuing rentals due under this Lease, together with interest thereon at 9% per annum.

E) LIENS:
LESSEE shall be permitted to install personal property such as trade fixtures and place liens thereon and LESSOR agrees to execute such WAIVERS OF LIEN as may be required by vendor or financing institutions. Any liens permitted shall be only against personal property and not against the realty or Leased Premises. LESSEE, at the end of the basic term of this Lease, or any extension thereof, will not remove from the Leased Premises personal property, such as trade fixtures, and title thereto shall pass to LESSOR.

F) ZONING AND LICENSING:
The LESSOR represents that there are no covenants or restrictions which would prohibit or limit the LESSEE from operating on the demised premises a nursing home and rest home for adults and that all licenses and permits, including but not limited to those pertaining to building and occupancy, which are necessary to LESSEE'S business, can be obtained. The LESSOR agrees upon request by LESSEE

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to sign promptly and without charge therefor to the LESSEE, any application for licenses and permits as may be required by the LESSEE for the conduct and operation of the business herein authorized or for the proper use of the demised premises.

7. MUTUAL COVENANTS:

The following stipulations and agreements are expressly understood by both the LESSOR and the LESSEE, and they do hereby agree to abide by them:

A) Neither party shall have the right to cancel this Lease for default of the other unless such default shall remain uncured for a period of thirty (30) days after notice in writing to such other party specifying the nature of the default.

B) The covenants and agreements contained in this Lease are interdependent and are binding on the parties hereto, their successors and assigns.

C) It is mutually understood and agreed that, in the event it shall become necessary for either party to enforce the provisions of this Lease by legal action or employ attorneys for the collection of any monies due hereunder, then the prevailing party shall be entitled to recover its reasonable attorney's fees, court costs and other costs of such proceedings.

D) LESSOR and LESSEE herein agree to make and execute a Declaration of Lease in recordable form, so as to give public notice of the execution of the within Lease, and a statement therein as to the date of commencement of the within Lease, which shall not disclose the terms of rental or additional rental hereunder.

8. ASSIGNMENT AND SUBLETTING:

The LESSEE may not assign this Lease or let or underlet the whole or any part of said premises without the written consent of the LESSOR.

9. DAMAGE TO OR DESTRUCTION OF PREMISES:

In case the demised premises and/or the building or buildings wherein the demised premises are located shall at any time

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during the term hereby granted or extensions thereof be damaged by fire, flood, tornado, riot, insurrection, or by elements or otherwise, whether rendered untenable or not, LESSEE shall give immediate written notice thereof to LESSOR and the rent herein stipulated shall abate during said period of untenantability. Thereafter, LESSEE may thereupon and without further notice to LESSOR repair or replace said building, provided, however, that LESSEE shall not be required or obligated to expend for such repairs or replacement any amount in excess of the proceeds derived from applicable insurance policies paid to LESSEE as a result thereof. In the event Buildings are more than 60% destroyed and LESSEE elects not to repair or replace the building, LESSEE may declare this Lease terminated as of the date of said damage or destruction whereupon LESSOR shall be entitled to receive the proceeds derived from any insurance applicable to the building or buildings on the premises.

10/19/72 MCT

10. REPAIRS AND ALTERATIONS:

LESSEE shall maintain the premises in good structural condition and repair, shall make all structural repairs and replacements necessitated by any cause other than LESSOR'S negligence, and shall make all repairs or replacements necessitated by any peril covered by a Standard Fire and Extended Coverage insurance policy, whether or not caused by LESSOR'S negligence.

LESSEE or any sub-lessee may make alterations, additions and improvements to the demised premises from time to time during the term of this Lease, with~~out~~ the consent of LESSOR and shall have the right to erect and install such other or additional improvements and equipment on the demised premises as LESSEE may, ~~in its sole judgment~~, deem desirable for conducting its business thereon or for such other business as LESSEE may deem advisable. Lessors Consent shall not be unreasonably withheld LESSEE shall have no authority to create or place any lien or encumbrance of any kind whatsoever upon or in any manner to bind the interest of LESSOR in the demised premises, and LESSEE covenants and agrees promptly to pay all

10/19/72 MCT

OVE, BALDUCCI
AND
SCACCIA
TORNEYS AT LAW
SYRACUSE, N. Y.

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sums legally due and payable by it on account of any labor performed by it on the demised premises upon which any lien is or can be asserted against the demised premises or the improvements thereon.

11. LESSOR DEFAULT:

Should LESSOR default in the performance of any covenant required to be performed by LESSOR, LESSEE may serve upon LESSOR a notice specifying the default and requiring performance by the LESSOR within a period of time set forth in such notice, which shall not be less than fifteen nor more than thirty days. In the event that LESSOR shall not have remedied the default within the time set forth in the notice or, if the nature of the default so requires, shall not have commenced to remedy the same, LESSEE may consider this Lease terminated, unearned rent shall be prorated to the date of termination and LESSEE shall have no further liability. In the event of such default by LESSOR after notice shall have been given as aforesaid, in lieu of termination of this Lease LESSEE at its sole option, may cure LESSOR'S default and offset the reasonable expense thereof against rent thereafter accruing.

12 LESSEE DEFAULT:

If LESSEE shall fail to pay any installment of rent promptly on the day the same shall become due and payable hereunder, and shall continue in such default for a period of Thirty (30) days after written notice thereof by LESSOR, or if LESSEE shall fail to promptly keep and perform any other affirmative covenant of this Lease, strictly in accordance with the terms of this Lease and shall continue in default for a period of Thirty (30) days after written notice thereof by LESSOR of default and demand of performance, then and in any such event and as often as any such event shall occur, LESSOR may (a) declare the said term ended, and enter into said premise demised or any part thereof, either with or without process of law, and expel

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LESSEE or any person occupying the same in or upon said premises, using such force as may be necessary, and to repossess and enjoy said premises as in LESSOR'S former estate; or (b) re-let the premises, applying said rent from the new tenant on this Lease, and LESSEE shall be responsibile for no more than the balance that may be due, should a balance exist. However, if any default shall occur, other than in the payment of money, which cannot with due diligence be cured within a period of Thirty (30) days, and LESSEE, prior to the expiration of Thirty (30) days from and after the giving of notice as aforesaid, commences to eliminate the cause of such default and proceeds diligently and with reasonable dispatch to take all steps and do all work required to cure such default, then LESSOR shall not have the right to declare the said term ended by reason of such default.

13. SUBORDINATION AND NON-DISTRUBANCE:

The Lease shall be subject and subordinate to the lien of any mortgage which LESSOR may place upon the premises and to any renewal, extensions, modifications or replacement thereof.

10/19/72 MCT

~~The parties hereto agree to execute such reasonable documents as may be necessary to effectuate said subordination.~~

14. MISCELLANEOUS PROVISIONS:

A) NOTICES, DEMANDS AND OTHER INSTRUMENTS:

All notices, demands, requests, consents, approvals and other instruments required or permitted to be given pursuant to the terms hereof shall be in writing and shall be deemed to have been properly given if sent by registered or certified mail, postage prepaid, or telegram, charges prepaid, addressed to the parties herein at the addresses shown on the first page hereof.

B) BINDING EFFECT:

All of the covenants, conditions and obligations herein contained shall be binding upon and inure to the benefit of the respective successors and assigns of the parties hereto to the same

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extent as if each such successor and assign were in each case named as a party to this Lease. This Lease may not be changed, modified or discharged, except by a writing signed by both LESSOR and LESSEE.

C) SEPARABILITY:

Each and every covenant and agreement contained in this Lease shall for all purposes be construed to be a separate and independent covenant and agreement, and the breach of any covenant or agreement contained herein by either party shall in no way or manner discharge or relieve the other party from its obligation to perform each and every covenant and agreement herein.

D) HEADINGS AND TERMS:

The headings to the various paragraphs of this Lease have been inserted for convenient reference only and shall not in any manner be construed as modifying, amending or affecting in any way the express terms and provisions hereof. The term "person" when used in this Lease, shall mean any individual, corporation, partnership, firm, trust, joint venture, business association, syndicate, combination organization or any other person or entity.

E) CONSTRUCTION OF LEASE:

Words of any gender used in this Lease shall be held to include any other gender, and words in the singular number shall be held to include the plural, when the sense requires. Wherever used herein, the words "LESSOR" and "LESSEE" shall be deemed to include the heirs, personal representatives, successors, sublessees and assigns of said parties, unless the context excludes such construction.

CASTLE REST FACILITIES CORPORATION (LESSOR)

By Harold C. Tracy
Harold C. Tracy, Secretary

CASTLE REST NURSING HOME (LESSEE)

By Thomas M. Fahey
Thomas M. Fahey,

(Settlement and Financing Papers — Group E) *
Exhibit E-14 — Lease of Real Property to Thomas Fahey from
Castle Rest Facilities Corp. (10/19/72).

E-14

SCHEDULE "A"

ALL that certain plot, piece or parcel of land, with the buildings and improvements thereon erected, situate, lying and being in the City of Syracuse, County of Onondaga and State of New York, being part of Lots 1, 10 and 11 Block 1013 in said City, bounded and described as follows:

BEGINNING at the intersection of the westerly line of South State Street with the southerly line of East Castle Street; running thence from the above mentioned point of beginning South 19° 45' 50" East along the westerly line of South State Street 264.0 feet; thence South 70° 53' 20" West 233.53 feet; thence North 19° 39' 10" West 44.0 feet; thence South 70° 53' 20" West 44.06 feet; thence North 19° 39' 10" West 88.0 feet; thence South 70° 53' 20" West 20.0 feet; thence North 19° 39' 10" West 132.0 feet to the southerly line of East Castle Street; thence North 70° 53' 20" East along the southerly line of East Castle Street 297.0 feet to the place of beginning.

Subject to right of way and easement granted by 115 East Castle Corporation to Bela Sternberg and Clara Sternberg dated Aug. 15, 1966 and recorded August 21, 1967 in the Onondaga County Clerk's Office in Liber 2350 of Deeds, page 205.

(Settlement and Financing Papers — Group E) *
Exhibit E-15 — Assignment of Lessor's Interest in Lease to
Rochester Savings Bank (10/19/72).

Exh E-15

ASSIGNMENT OF LESSOR'S INTEREST IN LEASE

THIS AGREEMENT made this 19th day of October 1972, between CASTLE REST FACILITIES CORPORATION, a New York Corporation with offices located at 415 Stratford Street, Syracuse, New York, hereinafter called "Assignor", and ROCHESTER SAVINGS BANK, a banking corporation organized and existing under the laws of the State of New York, having its principal office at 40 Franklin Street, Rochester, New York, hereinafter called "Assignee",

W I T N E S S E T H :

FOR VALUE RECEIVED, Assignor hereby grants, transfers and assigns to the Assignee all of the right, title and interest of Assignor in and to a certain lease dated the 18th day of October 1972, between Assignor as Lessor and

as Lessee, which said lease demises for a term of 20 years premises known as

Castle Rest Nursing Home, located at 116 East Castle Street, City of Syracuse, Onondaga County, New York, as more particularly described in said lease,

TOGETHER with all rents, income and profits arising from said lease, and any and all extensions and renewals thereof,

FOR THE PURPOSE OF SECURING:

1. Payment of the indebtedness evidenced by that certain Note (including any extensions or renewals thereof) in the principal sum of Two Million Two Hundred Thousand Dollars ($2,200,000.00) made by Assignor and predecessor in title on the day of October, 1972 and September 22, 1966 payable to the order of Assignee and secured by a mortgage on real property recorded in Onondaga County Clerk's Office on even date,

2. Payment of all advances and other sums with interest thereon becoming due and payable to the Assignee under the provisions hereof or under the provisions of said Notes, Mortgages and Consolidation and Extension Agreement or any sums secured by said instruments.

3. Performance and discharge of each and every obligation, covenant and agreement of Assignor herein or arising from said Notes, Mortgages and Consolidation and Extension Agreement,

ASSIGNOR AGREES: -

1. To faithfully abide by, perform and discharge each and every obligation, covenant and agreement of said lease by Lessor to be performed; at the sole cost and expense of Assignor, to enforce or secure the performance of each and every obligation, covenant, condition and agreement of said Lease by the Lessee to be performed;

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not to modify, extend or in any way alter the terms of said lease or accept a surrender thereof; not to anticipate the rents thereunder, or to waive, excuse, condone or in any manner release or discharge the Lessee thereunder of or from the obligations, covenants, conditions and agreements by said Lessee to be performed, including the obligation to pay the rental called for thereunder in the manner and at the place and time specified therein, and Assignor does by these presents expressly release, relinquish and surrender unto the Assignee all his right, power and authority to amend, modify, or in any way alter the terms or provisions of said lease.

2. At Assignor's sole cost and expense to appear in and defend any action or proceeding arising under, growing out of or in any manner connected with the said lease or the obligations, duties or liabilities of Lessor and Lessee thereunder, and to pay all costs and expenses of the Assignee, including attorney's fees in a reasonable sum in any action or proceeding concerning said lease in which the Assignee may appear.

3. That should the Assignor fail to make any payment or to do any act as herein provided, then the Assignee, but without obligation so to do and without notice to or demand on Assignor, and without releasing Assignor from any obligation hereof, may make or do the same in such manner and to such extent as the Assignee may deem necessary to protect the security hereof, including specifically, without limiting its general powers, the right to appear in and defend any action or proceeding purporting to affect the security hereof or the rights or powers of the Assignee, and also the right to perform and discharge each and every obligation, covenant and agreement of Lessor in said lease contained; and in exercising any such powers to pay necessary costs and expenses, employ counsel and incur and pay reasonable attorney's fees.

4. To pay immediately upon demand all sums expended by the Assignee under the authority hereof, together with interest thereon at the highest rate for which it is now lawful to contract.

IT IS MUTUALLY AGREED THAT:

1. So long as there shall exist no default by the Assignor in the payment of any indebtedness secured hereby or in the performance of any obligation, covenant or agreement herein, or in said Notes, Mortgages and Consolidation and Extension Agreement contained, Assignor shall have the right to collect upon, but not prior to accrual, all rents, issues and profits from said leased premises and to retain, use and enjoy the same.

2. Upon or at any time after default in the payment of any indebtedness secured hereby or in the performance of any obligation, covenant or agreement herein or in said Notes, Mortgages and Consolidation and Extension Agreement contained, the Assignee may, at its option, without notice and without regard to the adequacy of security for the indebtedness hereby secured, either in person or by agent with

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or without bringing any action or proceedings, or by a receiver to be appointed by a court, enter upon, take possession of, manage and operate said demised premises or any part thereof; make, cancel, enforce or modify leases; obtain and evict tenants, and fix or modify rents, and do any acts which the Assignee deems proper to protect the security hereof, and either with or without taking possession of said property, in its own name sue for or otherwise collect and receive such rents, issues and profits, including those past due and unpaid, and apply the same, less costs and expenses of operation and collection, including reasonable attorney's fees, upon any indebtedness secured hereby, and in such order as the Assignee may determine. The entering upon and taking possession of said property or the collection of such rents, issues and profits and the application thereof as aforesaid, shall not cure or waive any default or waive, modify or effect notice of default under said mortgage or invalidate any act done pursuant to such notice.

3. The Assignee shall not be obligated to perform or discharge, nor does it hereby undertake to perform or discharge, any obligation, duty or liability under said lease; or under or by reason of this Assignment, and the Assignor shall and does hereby agree to indemnify and to hold the Assignee harmless of and from any and all liability, loss or damage which it may or might incur under said lease or under or by reason of this Assignment and of and from any and all claims and demands whatsoever which may be asserted against it by reason of any alleged obligations or undertaking on its part to perform or discharge any of the terms, covenants or agreements contained in said lease; should the Assignee incur any such liability, loss or damage under said lease or under or by reason of this Assignment, or in the defense of any such claims or demands, the amount thereof, including costs, expenses and reasonable attorney's fees, shall be secured hereby, and Assignor shall reimburse the Assignee therefor immediately upon demand.

4. Until the indebtedness secured hereby shall have been paid in full, Assignor covenants and agrees to transfer and assign to the Assignee any and all subsequent leases upon all or any part of said demised premises upon the same or substantially the same terms and conditions as are herein contained, and to make, execute and deliver to the Assignee, upon demand, any and all instruments that may be necessary therefor.

5. Upon the payment in full of all indebtedness secured hereby, this Assignment shall become and be void and of no effect, but the affidavit of any officer of the Assignee showing any part of said indebtedness remaining unpaid shall be and constitute conclusive evidence of the validity, effectiveness and continuing force of this Assignment, and any person may and is hereby authorized to rely thereon.

6. This Assignment applies to, inures to the benefit of, and binds all parties hereto, their successors and assigns. The term "Lease" as used herein means the lease hereby assigned or any extension or renewal

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thereof or any lease subsequently executed by Assignor covering the demised premises above described or any part thereof.

7. All notices, demands, or documents of any kind which the Assignee may be required to or may desire to serve upon Assignor hereunder, may be served by delivering the same to the Assignor personally, or by leaving a copy of such notice, demand or document addressed to Assignor at his address appearing opposite his signature hereinbelow, or by depositing a copy of such notice, demand, or document in the United States mail, postage prepaid, and addressed to the Assignor at his said address, or to such address that may have been furnished to the Assignee in writing by the Assignor for this purpose.

8. Reference is made to Section 291F of the Real Property Law of the State of New York, and this assignment is made in accordance with the provisions of such Section.

Assignor warrants that there has been no prepayment or anticipation of rent provided for in said lease and that said lease has not been amended or modified except as set forth herein. Assignor further warrants that no default exists in said lease, and that it has not been previously assigned.

IN WITNESS WHEREOF, Assignor has duly executed this Assignment.

CASTLE REST FACILITIES CORPORATION

By

Address of Assignor: -

415 Stratford Street
Syracuse, New York

STATE OF NEW YORK)
COUNTY OFONONDAGA) SS:
CITY OF SYRACUSE)

On this day of October , 19 72, before me, the subscriber, personally appeared
to me known, who being by me duly sworn, did depose and say that he resides at
and is of CASTLE REST FACILITIES CORPORATION, the corporation described in and which executed the foregoing instrument; that he knows the seal of said corporation, that the seal affixed to said instrument is such corporate seal; that it was so affixed by order of the Board of Directors of said corporation, and that he signed his name thereto by like order.

STATE OF)
COUNTY OF) SS:
CITY OF

On this day of , 19 , before me, the subscriber, personally appeared
to me known and known to me to be the individual described in and who executed the within instrument, and severally duly acknowledged to me that executed the same.

(Settlement and Financing Papers — Group E) *
Exhibit E-16 — Personal Property Lease to Thomas Fahey from Castle Rest Facilities Corp. (10/19/72).

Exh E-16

PERSONAL PROPERTY LEASE

THIS AGREEMENT, made this 19th day of October, 1972, between CASTLE REST FACILITIES CORPORATION, a corporation organized and existing under the laws of the State of New York, with offices located at 116 East Castle Street, Syracuse, New York, party of the first part, hereinafter known as Lessor and

THOMAS M. FAHEY, residing in Syracuse, New York, party of the second part, hereinafter known as Lessee.

W I T N E S S E T H:

The personal property covered by this agreement is described as all of the furniture, fixtures, furnishings, equipment and all other items of personal property used in the operation of the business known as Castle Rest Nursing Home and Castle Rest Home for Adults.

The Lessor in consideration of the covenants and agreements herein contained to be kept and performed by the Lessee, has agreed to lease to the Lessee and does hereby lease to the Lessee and the Lessor in consideration of the covenants and agreements herein contained to be kept and performed by the Lessor, has agreed to take from the Lessor and does hereby take from the Lessor, the personal property above described to be used for the purpose of the Lessee in his operation of the said business, for the term of twenty (20) years, to commence on the 19th day of October, 1972 at rent set forth in the real property lease of even date.

It is hereby mutually understood and agreed that this instrument shall apply to and bind the heirs, legal representatives successors, assigns or grantees, as the case may be, of each of the parties hereto.

It is hereby further mutually understood and agreed that

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(Settlement and Financing Papers — Group E) *
Exhibit E-16 — Personal Property Lease to Thomas Fahey
from Castle Rest Facilities Corp. (10/19/72).

during the term of this lease, Lessee will pay for all repairs, improvements and replacements of the said personal property and at the end of said term, will deliver up the same in as good condition and order as they were at the commencement of this Lease, reasonable use and wear excepted.

IN WITNESS WHEREOF, the parties hereunto set their hands and seal the day and year first above written.

CASTLE REST FACILITIES CORPORATION

By Marie C Tracy Secretary
Lessor

Witness

Witness

Thomas M. Fahey, Lessee

(Accounting Documents — Group F) *
Index to Group F.

F

Re U.S. v. Thomas Fahey

Group F - Accounting Documents

Exh F-1 3/17/66	Letter of Instruction with U. S. Partnership Return for the year 1965, From Ernst & Ernst.	/
Exh F-2 2/14/67	Letter of Instruction with U. S. Partnership Return for the year 1966, From Ernst & Ernst.	/
Exh F-3 4/2/68	Letter of Instruction with U. S. Partnership Return for the year 1967, From Ernst & Ernst.	/
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(Accounting Documents — Group F) *
Exhibit F-1 — Letter of Instruction with U. S. Partnership Return for the year 1965, From Ernst & Ernst (3/17/66).

PARTNERSHIP COPY

ERNST & ERNST
STATE TOWER BUILDING
SYRACUSE, N.Y. 13202

Exh F-1

March 17, 1966

Mr. Thomas Fahey
415 Stratford Street
Syracuse, New York

Dear Mr. Fahey:

We enclose in duplicate U.S. Partnership Return of Income of Walker McKinney Associates for the period from January 4, 1965 to December 31, 1965. The original should be signed and dated by a partner and forwarded to Internal Revenue Service, Buffalo, New York 14202 in sufficient time to reach that office on or before April 15, 1966. The form marked "Taxpayer's Copy" is for your files.

There is no tax due with this return. Each partner should include in his 1965 U.S. Individual Income Tax Return the loss shown opposite his name in Schedule K, Column 4. A xerox copy for each of the partners entitled to a loss deduction is also enclosed.

Very truly yours,

Alan E. Baer

Manager

AEB:rlc
Enclosures

(Accounting Documents — Group F) *
Exhibit F-2 — Letter of Instruction with U. S. Partnership Return for the year 1966, From Ernst & Ernst (2/14/67).

PARTNERSHIP COPY

ERNST & ERNST
STATE TOWER BUILDING
SYRACUSE, N. Y. 13202

Entd F-2

February 14, 1967

Mr. Thomas Fahey
Walker McKinney Associates
205 Midtown Plaza
Syracuse, New York

Dear Mr. Fahey:

We enclose in duplicate U.S. Partnership Return of Income of Walker McKinney Associates for the year ended December 31, 1966. The original should be signed and dated by a partner and forwarded to Internal Revenue Service, Buffalo, New York 14202 in sufficient time to reach that office on or before April 15, 1967. The form marked "Taxpayer's Copy" is for your files.

There is no tax due with this return. Each partner should include in his 1966 U.S. Individual Income Tax Return the amounts shown opposite his name in Schedule K, Column 4. A Xerox copy for each of the partners is also enclosed.

Very truly yours,

Alan E Boris

Partner

AEB/jb
Enclosures

(Accounting Documents — Group F) *
Exhibit F-3 — Letter of Instruction with U. S. Partnership Return for the year 1967, From Ernst & Ernst (4/2/68).

ERNST & ERNST
STATE TOWER BUILDING
SYRACUSE, N.Y. 13202

F, LC

Exh F-3

April 2, 1968

Mr. Thomas Fahey, Partner
Castle Rest Nursing Home
116 East Castle Street
Syracuse, New York 13205

Dear Mr. Fahey:

We enclose in duplicate U. S. Partnership Return of Income of Castle Rest Nursing Home for the year ended December 31, 1967. The original should be signed and dated by a partner and forwarded to Internal Revenue Service, Buffalo, New York 14202 in sufficient time to reach that office on or before April 15, 1968. The form marked "Taxpayer's Copy" is for your files.

There is no tax due with this return. Each partner should include in his 1967 U. S. Individual Income Tax Return the amounts shown opposite his name in Schedule K, Column 4. The partners' attention is also called to lines 3(ii) and 3(iii) of Schedule K which indicates the basis of partnership property subject to investment credit computation on their respective returns.

A xerox copy for each of the partners is also enclosed.

Very truly yours,

Alan E. Beers

Partner

AEB/smp
Enclosures

RECEIVED APR 5 1968

(Citations and Authorities — Group G) **
Index to Group G.

RE: U.S. v. Thomas Fahey

G

GROUP G

Citations and Authorities

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Exhibit

G-1	Aronsohn, Alan J. B., Partnerships and Income Taxes (1957, 1966, 1970), Practicing Law Institute - Effect of Partnership Agreement	3
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(Citations and Authorities — Group G) **
Exhibit G-1 — Aronsohn, Alan J. B., Partnerships and Income Taxes (1957, 1966, 1970), Practicing Law Institute — Effect of Partnership Agreement.

[Exh. G-1] G-1

PARTNERSHIPS AND INCOME TAXES

Alan J. B. Aronsohn

1970

EFFECT OF PARTNERSHIP AGREEMENT

A partner's distributive share of any item is determined by the partnership agreement,[78] unless the principal purpose of any provision in the partnership agreement with respect to such item is the avoidance or evasion of federal income tax.[79] If the partnership agreement does not provide as to any particular item, or the principal purpose of any provision with respect to such item is the avoidance or evasion of income tax, the distributive shares of such item are determined in accordance with the ratio in which the partners divide the general profits or losses of the partnership.[80] This includes gain with respect to partnership §1245 or §1250 property. If the partnership agreement provides for the allocation of the total gain from such property, but makes no special allocation of the portion of such gain treated as ordinary income under §1245(a)(1) or §1250(a)(1), all gain will be allocated in the proportion in which the total gain is allocated.[80a]

A "partnership agreement" is defined as including any modifications made up to the time for filing the partnership return for the taxable year (not including, however, any extensions of time for filing).[81] Local law is considered a part of the agreement as to any matters on which the agreement is silent.[82]

Despite the foregoing limitations, it may be possible to allocate among the members of a partnership various items of income

(Citations and Authorities — Group G) **
Exhibit G-1 — Aronsohn, Alan J. B., Partnerships and Income Taxes (1957, 1966, 1970), Practicing Law Institute — Effect of Partnership Agreement.

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and deduction in such a manner that the parties concerned will obtain some tax benefit. If such allocation has economic effect independent of the tax consequences, it should be respected.[83] For example, the Senate Committee Report to the 1954 Code indicates that an agreement allocating all of the dividend income to one partner and all of the tax-exempt interest to another partner will be respected for tax purposes, provided that in economic effect the partner to whom all of the dividend income is being allocated bears the economic risk of the presence or absence of dividend income and the partner to whom all of the tax-exempt interest is being allocated bears the economic risk of the presence or absence of tax-exempt interest.[84] The regulations state, however, that the presence or absence of "substantial economic effect" in any special allocation provided in a partnership agreement is only one of the facts and circumstances to be considered in determining whether the principal purpose of the allocation is the avoidance or evasion of income tax. Other relevant factors include the presence or absence of a "business purpose", the method of allocating related items, the recognition or nonrecognition of "normal business factors", the timing of the allocation either before or after the amount of the allocated item can be reasonably estimated, the duration of the allocation and its "over-all tax consequences".[85]

The regulations do indicate, however, that in the usual "money-man and expert" partnership, where one of the partners contributes the bulk of the capital required, and another partner provides services, it is permissible for the partnership agreement to provide that the deduction for the partnership's anticipated early losses shall be allocated to the money-man, who in

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fact actually bears the economic risk, even though the agreement provides for a different sharing of profits and losses after the business has become established.[86]

[78]I.R.C. §704(a); Reg. §1.704-1(a).

[79]I.R.C. §704(b)(2).

[80]I.R.C. §704(b); Reg. §1.704-1(b).

[80a]Reg. §1.1245-1(e)(2); Prop. Reg. §1.1250-1(e).

[81]I.R.C. §761(c); Conference Committee Rep., H.R. Rep. No. 2543, 83rd Cong., 2d Sess. 65-66 (1954); Commissioner v. Jackson Inv. Co., 346 F.2d 187 (9th Cir. 1965); Smith v. Commissioner, note 45, p. 131 infra; David A. Foxman, 41 T.C. 535 (1964), aff'd, 352 F.2d 466 (3rd Cir. 1965).

[82]Reg. §1.761-1(c).

[83]Sen. Rep. No. 1622, 83rd Cong., 2d Sess. 379 (1954); cf. Jackson et. al., The Internal Revenue Code of 1954: Partnerships, 54 Colum. L. Rev. 1187-89 (1954). The Internal Revenue Service has ruled that allocations of items among partners are permissible under the 1939 Code provided income tax avoidance is not the purpose of the allocations. Rev. Rul. 57-138, 1957-1 C.B. 543.

[84]Sen. Rep. No. 1622, supra note 83. See also Reg. §1.704-1(b)(2), Example (3); Rev. Rul. 66-187, 1966-2 C.B. 246.

[85]Reg. §1.704-1(b)(2).

[86]See Reg. §1.704-1(b)(2), Example (5), amended by T.D. 6771, filed Nov. 19, 1964, reproduced at pp. 62-63 infra, Rev. Rul. 68-139, 19-68-1 C.B. 311; cf. Cleveland v. Commissioner, 297 F.2d 169 (4th Cir. 1961). As to the possible realization of income by "expert" upon the formation of such a partnership, see p. 58 infra.

(Citations and Authorities — Group G) **
Exhibit G-2 — Aronsohn, Alan J. B., Partnerships and Income Taxes (1957, 1966, 1970) — Depreciation or Depletion with Respect to Contributed Property.

Sylk G-2 6-2/1

PARTNERSHIPS AND INCOME TAXES

Alan J. B. Aronsohn

1970

Depreciation or Depletion with Respect to Contributed Property

Any depreciation or depletion upon contributed property is computed on the same tax basis as gain or loss on disposition,[6] and allowable depreciation or depletion (other than percentage depletion) on such property is allocated among the partners in the same manner as is gain or loss; i.e., by taking into account all or part of the difference between the adjusted basis and the fair market value of the property at the time of contribution, if the agreement so provides, or as though such items arose with respect to property purchased by the partnership, if the agreement is silent in this respect.[7]

For example, if A and B form a partnership to which A contributes $10,000 and B contributes property which is worth $10,000 and is so accepted on the partnership books, but which has an adjusted basis of only $7,500, and the property contributed by B is depreciable at the rate of 10 per cent per year, the allowable tax deduction for depreciation for the first year would be $750 (10 per cent of $7,500 basis). Depreciation taken on the basis of book value would be $1,000 (10 per cent of $10,000). If the partnership's earnings for the year are $6,000 before deducting depreciation, the net taxable income for the year will be $5,250. The total amount available for credit to the partners' accounts on the books, however, will be only $5,000 ($6,000 less $1,000 book depreciation), or $2,500 to each. If the partnership agreement does not provide otherwise, the allowable depreciation for tax purposes will be allocated between A and B equally and both will realize $2,625 of partnership taxable

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income for the year (one-half of $6,000 minus one-half of $750). The partnership agreement may provide, however, that A is to receive the benefit of a sufficient portion of the allowable depreciation deduction to offset the economic depreciation to his interest in the property; i.e., that the allowable deduction of $750 shall be allocated $500 to A and $250 to B. In such case there is taxable partnership income of $2,500 to A and $2,750 to B.

If the adjusted basis of the contributed property in the foregoing example is only $2,500, and therfore allowable depreciation is only $250 per year, the partnership agreement can provide that the entire $250 allowable deduction shall be allocated to A. On the basis of $6,000 of income before depreciation, A will therefore realize $2,750 of taxable partnership income and B will realize $3,000 of taxable partnership income.[8]

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[6] I.R.C. §167(f).

[7] I.R.C. §704(c); Reg. §1.704-1(c).

[8] Only the so-called "ceiling approach" allocation is allowed. Partner A may not be allowed full book depreciation ($500), since this might require partner B to realize income during a partnership loss year. Note 3, p. 52, supra.

(Citations and Authorities — Group G) **

Exhibit G-3 — Willis, A. B., Willis on Partnership Taxation (1971), Section 4.02(a) — Sample Article Defining Capital Accounts and Drawing Accounts.

Exh G-3

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WILLIS ON PARTNERSHIP TAXATION

Arthur B. Willis

1971

Section 4.02(a) Sample Article Defining Capital Accounts and Drawing Accounts

CAPITAL ACCOUNTS: DRAWING ACCOUNTS

A. An individual Capital Account shall be maintained for each partner. The capital interest of each partner shall consist of his original contribution of capital, increased by (1) additional capital contributions and (2) any credit balances transferred from his Drawing Account to his Capital Account and decreased by (a) distributions in reduction of partnership capital and (b) his share of partnership losses, if charged to the Capital Accounts of the partners.

B. The Capital Accounts of the partners shall be maintained at all times in the proportions of their interests in profits or losses of the partnership.

C. An individual Drawing Account shall be maintained for each partner. All withdrawals by a partner shall be charged to his Drawing Account. Withdrawals during the year shall be limited to such amounts as the partners, by a majority vote, shall determine from time to time. Each partner's share of any partnership net loss shall be charged to his Drawing Account, unless the partners by a majority vote agree to charge such loss to the Capital Accounts of the partners. Each partner's share of partnership profits shall be credited to his Drawing Account. The partners may determine by a majority vote to transfer to

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partnership capital all or any portion of the credit balances in the respective Drawing Accounts of the partners, provided that the amounts thus transferred shall be in the proportions of the partners' interests in profits or losses of the partnership.

D. A credit balance in a partner's Drawing Account shall constitute a liability of the partnership to that partner; it shall not constitute a part of that partner's interest in the capital of the partnership. A debit balance in a partner's Drawing Account, whether occasioned by drawings in excess of his share of partnership profits or by charging him for his share of partnership loss, shall constitute an obligation of that partner to the partnership and shall not reduce his interest in the capital of the partnership.

(Citations and Authorities — Group G) **
Exhibit G-4 — Willis, A. B., Willis on Partnership Taxation (1971), Section 19.09 — Special Allocation of Depreciation.

Exh G-4

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WILLIS ON PARTNERSHIP TAXATION

Arthur B. Willis

1971

§19.09 Special Allocation of Depreciation

The regulations do not contain an example of special allocation of depreciation. However, the matter contains enough facets of the special allocation problem to warrant consideration.

D and E form a partnership to erect and operate a commercial building. D contributes land valued at $100,000 and having an adjusted basis to D of $100,000. E contributes $100,000 in cash. Partner E insists that since his money is being used to erect the building, and D has contributed nondepreciable property, all the depreciation on the building is to be allocated to E for income tax purposes. E conditions his entering into the partnership on D's acceptance of the special allocation provision, so the agreement is, to that extent, a business arrangement. Will the special allocation be recognized for income tax purposes?

The question cannot be answered without more facts which establish or disprove the economic reality of the arrangement. Depreciation is a business expense and reduces business profits. If D and E share equally the net income before depreciation, and all the depreciation expense is charged to E, it is obvious that E has less than a 50 percent interest in the net income of the partnership. If that is what the partners intend, the special allocation does have economic substance and should be recognized. Of course, they could have reached the same result by revising the profit-and-loss ratios so that E's share of the partnership net income would be the equivalent of 50 percent of the net income before depreciation minus 100 percent of the depreciation.

(Citations and Authorities — Group G) **
Exhibit G-4 — Willis, A. B., Willis on Partnership Taxation
(1971), Section 19.09 — Special Allocation of Depreciation.

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The chances are that this isn't what E had in mind. So far as his business relationships with D are concerned, E expects to be an equal partner and to participate equally in partnership earnings. But once E insists that the allocation to him of all the depreciation be forgotten in any business reckoning with D, he loses the right to have the special allocation recognized. The special allocation of depreciation no longer has substantial economic effect. It is a sham, a mirage.

(Citations and Authorities — Group G) **

Exhibit G-5 — Willis, A. B., Willis on Partnership Taxation (1971), Section 19.12 — The Right of Other Partners to Challenge the Recognition of the Special Allocation for Income Tax Purposes.

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WILLIS ON PARTNERSHIP TAXATION

Arthur B. Willis

1971

Section 19.12 The Right of Other Partners to Challenge the Recognition of the Special Allocation for Income Tax Purposes

The inference in both the statute and the regulations is that the commissioner will be in opposition to the partners, or at least some of the partners, in the battle over recognition of the special allocation. Probably that is the way it will line up in most situations. However, there is nothing inherent in the statute or in the regulations that denies the right of a partner to challenge the income tax recognition of a special allocation provision in the partnership agreement.

If the question is raised by a partner, it will usually be the disgruntled partner who was pressured into an agreement allocating certain tax advantages to another partner. Perhaps the partnership has been dissolved and its assets distributed to the partners so all that remains open is the determination of the income tax liability of the partners for the years the partnership operated. The partners attacking the special allocation provision may have difficulty explaining why it should not be recognized, since they have agreed to it. Neither the statute nor the regulations, however, attempt to deny the partners' right to contend that a special allocation had as its principal purpose the avoidance or evasion of tax and, consequently, should be disregarded for income tax purposes.

(Citations and Authorities — Group G) **
Exhibit G-6 — Case Law on the "Advice of Counsel" Defense.
Prepared by defense counsel.

Exh 6-6

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CASE LAW ON THE "ADVICE OF COUNSEL" DEFENSE

Prepared by Defense Counsel

Lack of intent may be proven by evidence showing that the defendant did not report the income in question on advice of counsel. But this is not a defense unless you find that the defendant made a full disclosure of all the facts to his attorney, fully advised him as to all of the items of income which he did not report, and that the defendant acted in good faith on the advice given him by his attorney.

United States v. McCormick, 67 F. 2d 867 (C.A. 2d), certiorari denied, 291 U.S. 662.

If a person, in good faith, believes that he has paid all of the taxes he owes, he cannot be guilty of criminal intent to evade the tax. But if a person acts without reasonable ground for belief that his conduct is lawful, it is for the jury to decide whether he acted in good faith, or whether he willfully intended to evade the tax. This issue of intent, as to whether the defendant willfully attempted to evade or defeat the tax, is one which the jury must determine from a consideration of all the evidence in the case bearing on the defendant's state of mind.

United States v. Murdock, 290 U.S. 389, 394-398, 54 S. Ct., 223, 225, 226, 78 L. Ed. 387 (1933); United States v. Phillips, 217 F. 2d 435 (7th Cir. 1955); Battjes v. United States, 172 F. 2d 1 (6th Cir. 1949).

Ignorance or mistake of law is a defense. United States v. Murdock, supra.; United States v. James, 366 U.S. 213 (1961).

(Citations and Authorities — Group G) **
Exhibit G-6 — Case Law on the "Advice of Counsel" Defense.
Prepared by defense counsel.

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If a defendant can establish that he, in good faith, relied and acted upon the advice of an attorney or accountant or other qualified advisor in doing or refraining from doing an act made criminal if "willfully" committed, he has made out a valid defense. United States v. Phillips, 217 F. 2d 435 (C.A. 7th); Benetti v. United States, 97 F. 2d 263 (C.A. 9th); United States v. McCormick, 67 F. 2d 867 (C.A. 2d), certiorari denied, 291 U.S. 662; Lisansky v. United States, 31 F. 2d 846 (C.A. 4th), certiorari denied, 279 U.S. 873; United States v. Clayton-Kennedy, 2 F. Supp. 233 (?). He is, therefore, entitled to offer evidence to that effect and to have the issue thus raised submitted to a jury in a proper charge. United States v. Phillips, supra; Haigler v. United States, 172 F. 2d 986 (C.A. 10th).

But there are important qualifications to the scope of the advice of counsel defense. Obviously, it is most damaging evidence against the defendant if he receives proper advice and does not follow it. Barrow v. United States, 171 F. 2d 286 (C.A. 5th); Hill v. United States, _____ F. 2d _____ (C.A. 5th). In United States v. McCormick, supra, the taxpayer, as a deputy city clerk, had "exacted" a substantial amount of money from bridegrooms in connection with his performance of marriage ceremonies and had failed to report it as income. The taxpayer sought to show that the failure to make any return of the funds was not wilfull because he had consulted a legislator and two lawyers, all of whom were deceased at the time of trial. The conviction was sustained despite the ascertion of a lack of intent. The court stated that there was no attempt to show that the taxpayer's method of securing the funds was disclosed to the persons whom

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he consulted as to whether they should be returned as income; that the disclosure must be full in order to refute intent; and that it is not required that the jury be charged that partial disclosure may be evidentiary as to lack of intent. Thus, it is essential to the defense of reliance on advice of counsel or accountant that all the facts concerning taxpayer's income be disclosed. United States v. Cox, 348 F. 2d 294, 296 (C.A. 6th); United States v. Baldwin, 307 F. 2d 577, 579 (C.A. 7th), certiorari denied, 371 U.S. 947; Bisno v. United States, 299 F. 2d 711, 720 (C.A. 9th), certiorari denied, 370 U.S. 952, rehearing denied, 371 U.S. 855.

In Benetti v. United States, supra, the taxpayer claimed that he was advised by a deputy collector of internal revenue that he was not required to report income from his illegal business. It was held that under the circumstances it was proper for the trial court to charge the jury that there was a presumption of law that a public official entrusted with a public duty performs it in a lawful manner and that the presumption must be overcome by competent evidence. The court also sustained the charge to the jury that since the alleged advisor was dead at the time of trial, the taxpayer's testimony concerning the advise given "must be received by you with caution and the closest scrutiny and weighed by you in the light of all the testimony and evidence in the case".

The case of United States v. Phillips, supra, held it was error to refuse an instruction submitting the advice of counsel defense to the jury even though the only evidence on the point consisted of a recitation (elicited on cross-examination of government witnesses) of the defendant's self-serving explanations. The correctness of this decision might be questioned, but when

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confronted with this situation, government counsel should be alert to seek an off-setting qualification in such a charge to the effect that self-serving hearsay declarations of the defendant must be weighed with greatest caution. See Benetti v. United States, supra; Reagan v. United States, 157 U.S. 301, 310-311.

(Citations and Authorities — Group G) **
Exhibit G-7 — IRS Regulations, Section 1.703-1 Partnership Computations, (b) Elections of the partnership, (1) General rule.

Exh G-7

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IRS REGULATIONS

§1.703-1. Partnership computations.....

(b) Elections of the partnership - (1) General rule. Any elections (other than those described in subparagraph (2) of this paragraph) affecting the computation of income derived from a partnership shall be made by the partnership. For example, elections of methods of accounting, of computing depreciation, of treating soil and water conservation expenditures, and the option to deduct as expenses intangible drilling and development costs, shall be made by the partnership and not by the partners separately. All partnership elections are applicable to all partners equally, but any election made by a partnership shall not apply to any partner's nonpartnership interests.

(The Case for Dismissal — Group H) **
Index to Group H.

Re: U.S. V. Thomas Fahey

Group H

The Case for Dismissal

H-1 Memorandum on "The Case for Dismissal".

H-2 Letter from accounting firm, Ernst & Ernst, for submittal to the U.S. Attorney.

H-3 Application for extension of time (until June 15, 1970) to file 1969 partnership return on grounds that distribution of partnership income is in arbitration - Dated 4/9/70.

H-4 Second application for extension of time (until 9/15/72) to file 1969 partnership return on same grounds - Dated 6/11/73.

H-5 Letter from partner's attorney stating "It has been impossible to complete financial statements" because of the arbitration. - Dated 6/30/70.

H-6 Copy of affidavit obtained by Special Agent from partner (Metzger) stating no other agreement "ever existed" between the partners except the one signed by him on 11/15/65 (with letter of transmittal from partner Metzger - Dated 6/28/71).

H-7 Chart prepared during arbitration showing the evolution of three partnership agreements, and the changes that took place, including the major changes in depreciation.

H-8 Employment contract for partner McKinney (5/1/67) with letter agreement covering treatment of salary as draw on profits (9/6/67).

H-9 Employment contract for partner Simpson (5/1/67) with letter agreement covering treatment of salary as draw on profits (9/7/67).

(The Case for Dismissal — Group H) **
Exhibit H-1 — Memorandum on "The Case for Dismissal".

[The Memorandum on "The Case for Dismissal" is printed herein supra at page 499].

(The Case for Dismissal — Group H) **
Exhibit H-2 — Letter from accounting firm, Ernst & Ernst, for submittal to the U.S. Attorney.

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ERNST & ERNST
ONE MONY PLAZA
SYRACUSE, N.Y. 13202

May 6, 1974

Dante M. Scaccia, Esq.
300 Wilson Building
Syracuse, New York 13202

Dear Mr. Scaccia:

This letter has been prepared in response to a request from Thomas M. Fahey, d/b/a Castle Rest Nursing Home, and President and sole stockholder of the Castle Rest Facilities Corporation which presently owns the nursing home property.

We have been asked by Mr. Fahey, and by you, to prepare this statement for transmittal to the United States Attorney because we have been intimately familiar with the books and accounts of the nursing home. We have been continuously involved in the preparation of financial data covering the years 1965 through 1973, and currently into 1974 - - both as accountants and as auditors.

The scope of our accounting work has included the preparation of audited annual financial statements for the nursing home, and some of the cost and income reports required by the State of New York (for Medicaid), and by the U.S. Department of Health, Education and Welfare (for Medicare).

(The Case for Dismissal — Group H) **
Exhibit H-2 — Letter from accounting firm, Ernst & Ernst, for submittal to the U.S. Attorney.

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ERNST & ERNST

Dante M. Scaccia, Esq. -2- May 6, 1974

We prepared the first tax returns filed by the nursing home (for the calendar year 1965), and we have prepared all subsequent tax returns up to and including calendar year 1970.

The partnership agreement of November 16, 1965, was subject to various interpretations and caused bitter disputes between the partners. These disputes were so irreconcilable, that two of the partners sold their interests to the other partners. Immediately thereafter, the disputes between the two remaining partners erupted into court, and arbitration battles that lasted from June 1969 to October 1972. This resulted in the termination of Fahey as a partner in exchange for an arbitrated lump sum settlement of $170,000 - which was being appealed. The controversy was ended when Fahey acquired a large bank mortgage commitment and purchased the entire property and business from McKinney on October 19, 1972.

Where these disputes had an effect on the financial statements and tax returns, we relied on Mr. William Murray, legal counsel for both Castle Rest and Mr. Walker McKinney, the principal partner, for an interpretation of the agreement.

We discovered, when we were first engaged by Castle Rest in the fall of 1966, that the Castle Rest bookkeeper had been withholding tax on Fahey's draw for both the Federal and State governments. (Fahey

(The Case for Dismissal — Group H) **
Exhibit H-2 — Letter from accounting firm, Ernst & Ernst, for submittal to the U.S. Attorney.

ERNST & ERNST

H-2/3

Dante M. Scaccia, Esq. -3- May 6, 1974

was apparently unfamiliar with the technicalities of partnership tax accounting.)

We advised Fahey to stop withholding, and to claim appropriate refunds and credits from both the Federal and State governments.

Our letters of transmittal for the partnership tax returns for the taxable years 1965, 1966, and 1967 addressed to Mr. Fahey read in part as follows:

1965 - - "There is no tax due with this return. Each partner should include in his 1965 U.S. Individual Income Tax Return the loss shown opposite his name in Schedule K, Column 4. A xerox copy for each of the partners entitled to a loss deduction is also enclosed."

1966 - - "There is no tax due with this return. Each partner should include in his 1966 U.S. Individual Income Tax Return the amounts shown opposite his name in Schedule K, Column 4. A xerox copy for each of the partners is enclosed."

1967 - - "There is no tax due with this return. Each partner should include in his 1967 Individual Income Tax Return the amounts shown opposite his name in Schedule K, Column 4. The partners' attention is also called to lines 3 (ii) and 3 (iii) of Schedule K which indicates the basis of partnership

(The Case for Dismissal — Group H) **
Exhibit H-2 — Letter from accounting firm, Ernst & Ernst, for submittal to the U.S. Attorney.

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ERNST & ERNST

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Dante M. Scaccia, Esq. -4- May 6, 1974

property subject to investment credit computation on their respective returns.

These letters were prepared from worksheet form letters. In our practice at that time it was somewhat rare to have entries in Column 6, Schedule K, Form 1065. We did not specifically call Mr. Fahey's attention to that entry, and he could have drawn a conclusion that he was not required to include it in taxable income.

During the years we have been dealing with Mr. Fahey (since 1966), he has never asked us to do anything that we considered unprofessional or improper. He has always been frank, aboveboard, and sincerely interested in developing open and efficient accounting systems for his business.

We were surprised to learn that this matter had gone this far, in view of the disagreements among the partners as to the interpretation of the partnership agreement and the subsequent arbitration.

Very truly yours,

Alan E. Boers

Alan E. Boers
Partner

AEB:rms

(The Case for Dismissal — Group H) **

Exhibit H-3 — Application for extension of time (until June 15, 1970) to file 1969 partnership return on grounds that distribution of partnership income is in arbitration — Dated 4/9/70.

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Form **2758** (Rev. Oct. 1968)

Application for Extension of Time to File

U.S. FIDUCIARY OR PARTNERSHIP RETURN

Must be filed in DUPLICATE on or before the due date for filing the return. (See instruction 3.)

PLEASE TYPE OR PRINT

Name: Castle Rest Nursing Home

Number and street: 116 East Castle Street

City or town, State and ZIP code: Syracuse, New York 13205

Employer identification number: 16-6065495

(See reverse for filing instructions and return address. Small Business Corporations filing Form 1120S use Form 7004)

1. An extension of time until June 15, 1970 is hereby requested in which to file the following Federal return (Check one):
   - [X] Partnership return of income, Form 1065.
   - [ ] Fiduciary income tax return, Form 1041 (estate).
   - [ ] Fiduciary income tax return, Form 1041 (trust).
2. For calendar year 19 69, or other taxable year beginning ..... and ending .....
3. State *in detail* the reason the extension is needed (see instruction 4 on reverse side): The distribution of partnership income has been submitted to compulsory arbitration. The decision of the arbitrators has not been received but is expected by June 1, 1970.
4. IF THE EXTENSION IS FOR FORM 1041, FILL IN APPLICABLE AMOUNTS:
   (a) Amount of tax estimated to be due on the final return ..... $.....
   (b) Payment to be remitted with this application:
   (1) If a trust, the entire amount shown in line 4(a) above
   (2) If an estate, at least one-quarter of the amount shown in line 4(a) above } ..... $.....

SIGNATURE AND VERIFICATION

Under penalties of perjury, I declare that to the best of my knowledge and belief, the statements made herein are true and correct, that I am authorized by the above-named partnership, estate, or trust to prepare this application, and that I am:

- [X] A partner, fiduciary, or an officer representing the fiduciary.
- [ ] A member in good standing of the bar of the highest court of (specify jurisdiction) .....
- [ ] A certified public accountant duly qualified to practice in (specify jurisdiction) .....
- [ ] A person enrolled to practice before the Internal Revenue Service.
- [ ] A duly authorized agent holding a power of attorney. The power of attorney need not be submitted unless requested.

Signature Walter McKinney Date 4/9/70

THE INTERNAL REVENUE SERVICE WILL INDICATE BELOW WHETHER THE EXTENSION IS GRANTED OR DENIED AND WILL RETURN THE ORIGINAL OF THIS APPLICATION.

NOTICE TO APPLICANT—TO BE COMPLETED BY THE INTERNAL REVENUE SERVICE

- [X] The application is approved. This form must be attached to the return when filed as evidence that the extension was granted. **IN THE CASE OF AN ESTATE OR TRUST INTEREST ACCRUES AT THE RATE OF 6 PERCENT PER YEAR ON ANY TAX DUE FROM THE DATE THE TAX IS DUE TO BE PAID UNTIL IT IS PAID.**
- [ ] The application cannot be considered since it was received in this office after the due date of the return. The return should be filed without further delay. Please attach this form to the return to explain the delay in filing.
- [ ] Careful consideration has been given to the reasons and other data given in the application but it has been determined that the extension is not warranted. The return should be filed by the regular due date or within 10 days of the date of signature of this notice, if the end of such 10-day period is later than the regular due date. The 10-day period granted shall constitute a valid extension of time for filing returns for purposes of elections required to be made on timely filed returns. Please attach this form to the return to explain the delay in filing.
- [ ] Other .....

APR 9 1970 (Date)

(Director)

(The Case for Dismissal — Group H) **

Exhibit H-4 — Second application for extension of time (until 9/15/72) to file 1969 partnership return on same grounds — Dated 6/11/73.

[Exh H-4]

U.S. Treasury Department—Internal Revenue Service

Form **2758** (Rev. Oct. 1968)

Application for Extension of Time to File

U.S. FIDUCIARY OR PARTNERSHIP RETURN

H-4

PLEASE TYPE OR PRINT

Must be filed in DUPLICATE on or before the due date for filing the return. (See instruction 3.)

Name: CASTLE REST NURSING HOME

Number and street: 116 EAST CASTLE STREET

City or town, State and ZIP code: SYRACUSE, NEW YORK 13205

Employer identification number: 16-6065495

(See reverse for filing instructions and return address. Small Business Corporations filing Form 1120S use Form 7004)

1. An additional extension of time until September 15, 1970 is hereby requested in which to file the following Federal return (Check one):
   - [x] Partnership return of income, Form 1065.
   - [ ] Fiduciary income tax return, Form 1041 (estate).
   - [ ] Fiduciary income tax return, Form 1041 (trust).
2. For calendar year 19 69, or other taxable year beginning ..... and ending .....
3. State *in detail* the reason the extension is needed (see instruction 4 on reverse side): We were granted an extension of time to file until June 15, 1970 (see attached). Our attorneys have informed us that the arbitrators decision will not be received until after August (see attached).
4. IF THE EXTENSION IS FOR FORM 1041, FILL IN APPLICABLE AMOUNTS:
   (a) Amount of tax estimated to be due on the final return ..... $.....
   (b) Payment to be remitted with this application:
   (1) If a trust, the entire amount shown in line 4(a) above
   (2) If an estate, at least one-quarter of the amount shown in line 4(a) above } ..... $.....

SIGNATURE AND VERIFICATION

Under penalties of perjury, I declare that to the best of my knowledge and belief, the statements made herein are true and correct, that I am authorized by the above named partnership, estate, or trust to prepare this application, and that I am:

- [x] A partner, fiduciary, or an officer representing the fiduciary.
- [ ] A member in good standing of the bar of the highest court of (specify jurisdiction) .....
- [ ] A certified public accountant duly qualified to practice in (specify jurisdiction) .....
- [ ] A person enrolled to practice before the Internal Revenue Service.
- [ ] A duly authorized agent holding a power of attorney. The power of attorney need not be submitted unless requested.

Signature Walter McKinney by [illegible] Date 6-11-73

THE INTERNAL REVENUE SERVICE WILL INDICATE BELOW WHETHER THE EXTENSION IS GRANTED OR DENIED AND WILL RETURN THE ORIGINAL OF THIS APPLICATION.

NOTICE TO APPLICANT—TO BE COMPLETED BY THE INTERNAL REVENUE SERVICE

- [X] The application is approved. This form must be attached to the return when filed as evidence that the extension was granted. IN THE CASE OF AN ESTATE OR TRUST INTEREST ACCRUES AT THE RATE OF 6 PERCENT PER YEAR ON ANY TAX DUE FROM THE DATE THE TAX IS DUE TO BE PAID UNTIL IT IS PAID.
- [ ] The application cannot be considered since it was received in this office after the due date of the return. The return should be filed without further delay. Please attach this form to the return to explain the delay in filing.
- [ ] Careful consideration has been given to the reasons and other data given in the application but it has been determined that the extension is not warranted. The return should be filed by the regular due date or within 10 days of the date of signature of this notice, if the end of such 10-day period is later than the regular due date. The 10-day period granted shall constitute a valid extension of time for filing returns for purposes of elections required to be made on timely filed returns. Please attach this form to the return to explain the delay in filing.
- [ ] Other .....

JUN 25 1970 (Date)

Norman E. Ingram (Director)

(The Case for Dismissal — Group H) **

Exhibit H-5 — Letter from partner's attorney stating "It has been impossible to complete financial statements" because of the arbitration — Dated 6/30/70.

Exh H-5

H-5

HANCOCK, ESTABROOK, RYAN, SHOVE & HUST

COUNSELORS AT LAW

ONE MONY PLAZA

SYRACUSE, NEW YORK 13202

TELEPHONE (315) 471-3151

BENJAMIN E. SHOVE
RAYMOND A. HUST
HAROLD M. WEISENBERG
MORRIS BERMAN
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CHARLES H. BASSETT
A. VAN W. HANCOCK
JEROME H. SEARL
JAMES P. BURNS, JR.
H. HAROLD DWYER, JR.
PHILIP T. SEYMOUR
JOSEPH H. MURPHY
JOHN E. LYNCH
JOHN F. GATES
STEWART F. HANCOCK, JR.
ROBERT L. DUELL
JOHN W. MUNRO
HAMILTON S. WHITE
DOUGLAS E. ALLIS
JOHN J. YOUNG
NELSON F. COOK
JOHN M. HASTINGS, JR.
ROBERT V. HUNTER
W. CARROLL COYNE
LEWIS H. RYAN
DONALD P. McCARTHY

STEWART F. HANCOCK
1863-1950

LEWIS C. RYAN
1881-1961

CHARLES S. ESTABROOK
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JAMES T. SPAULDING
JOHN R. VARNEY
WILLIAM L. ALLEN, JR.
CHARLES M. UMBRECHT, JR.
JOHN T. HUNTER
DONALD J. KEMPLE
CARL W. [illegible]RSON, JR.
HOWARD [illegible]
ROBERT A. [illegible]
CLARK A. PITCHER
BRUCE G. BODEN
JAMES P. BURNS 3RD
JOHN E. DOBBERTIN
JAMES R. MCVETY
ROBERT F. BALDWIN JR.
MELVIN E. HOLM
WALTER L. MEAGHER, JR.
J. JEREMIAH MAHONEY, JR.
ROBERT J. HUGHES

June 3, 1970

Mr. Michael T. Foody
Ernst & Ernst
One Mony Plaza - 16th Floor
Syracuse, New York 13202

Re: Castle Rest Nursing Home Arbitration

Dear Mr. Foody:

By reason of an arbitration proceeding involving partners in the Castle Rest Nursing Home concern, it has been impossible to complete financial statements for the year 1969.

On or about May 25 initial briefs were filed in this arbitration proceeding and final briefs should be completed by July 1st. The arbitrators should not render their decision for a period of thirty to sixty days after final submission of briefs.

The decision in the arbitration then should not be forthcoming prior to August 1st.

Very truly yours,

HANCOCK, ESTABROOK, RYAN, SHOVE & HUST

By: Donald J. Kemple

Donald J. Kemple

DJK:ldp

RECEIVED JUN 15 1970

(The Case for Dismissal — Group H) **

Exhibit H-6 — Copy of affidavit obtained by Special Agent from partner (Metzger) stating no other agreement "ever existed" between the partners except the one signed by him on 11/15/65 (with letter of transmittal from partner Metzger — Dated 6/28/71).

Exhibit H-6

AFFIDAVIT

United States of America ~~Judicial~~ District of ~~New York~~ Northern) ss

I, THEODORE G. METZGER, state that:

I reside at Woodmancy Road, Tully, New York.

I was a partner in the partnership known as WALKER MC KINNEY AS CCIATES and also known as CASTLE REST NURSING HOME during the period 1965 through January or February 1969. The other partners were WALKER MCKINNEY, GEORGE SIMPSON and THOMAS PAHEY. My partnership share was purchased by the mother of WALKER MC KINNEY during early 1969.

All profit and/or loss relating to the partnership and the individual partners was governed by the Articles of Partnership of Walker Mc Kinney Associates which was signed by me on November 16, 1965.

To the best of my knowledge and belief no other written or oral agreement ever existed between the partners relating to the sharing of profit and/or loss or for that matter any other partnership business.

I have read the foregoing statement consisting of this page only. I fully understand this statement and it is true, accurate and complete to the best of my knowledge and belief. I made the corrections shown and placed my initials opposite each.

I made this statement freely and voluntarily, without any threats or rewards, or promises of reward having been made to me in return for it.

Subscribed and sworn to before me this 25th day of 71, at ~~Intelligence Division, 410 Hunter Plaza, Syracuse, New York.~~

(Signature of affiant)

(Signature)

Special Agent

(Title)

Internal Revenue Service

(Signature of witness, if any)

U.S. TREASURY DEPARTMENT - INTERNAL REVENUE SERVICE FORM 2311 (7-56)

GPO: 1971 O - 408136-B

(The Case for Dismissal — Group H) **

Exhibit H-6 — Copy of affidavit obtained by Special Agent from partner (Metzger) stating no other agreement "ever existed" between the partners except the one signed by him on 11/15/65 (with letter of transmittal from partner Metzger — Dated 6/28/71).

Exh H-6

3/3 H-6 2

SWIMMING POOL PRODUCTS
MORE FUN/LESS WORK

INDUSTRIES INC
FORMERLY SETABGEST CORPORATION

(315) 696-2671 TULLY, NEW YORK 13159

June 28, 1971

Mr. Thomas M. Fahey
East Lake Road
Skaneateles, N.Y. 13152

Dear Tom:

Enclosed is a copy of my sworn statement to the Internal Revenue Service.

My meeting to sign this elicited nothing beyond the substance of our discussion during the morning of June 25th.

Sincerely,

Ted

T. G. Metzger

TGM/ar

(The Case for Dismissal — Group H) **

Exhibit H-7 — Chart prepared during arbitration showing the evolution of three partnership agreements, and the changes that took place, including the major changes in depreciation.

(The Case for Dismissal — Group H) **
Exhibit H-8 — Employment contract for partner McKinney (5/1/67) with letter agreement covering treatment of salary as draw on profits (9/6/67).

Telephone: TE 1-3954

Exh H-8 H-8/1

THE McKINNEY CORPORATION
47 EAST 87th STREET
NEW YORK, N. Y. 10028

September 6, 1967

To: Mr. Thomas Fahey
Mr. Theodore Metzger
George Simpson, M.D.

Gentlemen:

This confirms my verbal committment to you all that any salary payments to me by the Castle Rest Nursing Home are to be considered to be distributions of profits to me by the partnership.

Yours very truly,

Walker McKinney

Walker McKinney

(The Case for Dismissal — Group H) **
Exhibit H-8 — Employment contract for partner McKinney (5/1/67) with letter agreement covering treatment of salary as draw on profits (9/6/67).

Exh 11-8 H-8 3/12

CASTLE REST NURSING HOME
116 East Castle Street
Syracuse, New York

May 1, 1967

Mr. Walker McKinney
47 East 87th Street
New York, N.Y.

Dear Mr. McKinney:

The purpose of this letter is to set forth the terms of the agreement between you and Castle Rest Nursing Home concerning your employment.

Castle Rest hereby agrees to employ you as its financial director. In this position, you will supervize the activities of Castle Rest's staff in the preparation of budgets and financial statements, render services in the obtaining of financing, and perform such other duties of a similar nature as you are directed by Castle Rest. You will hold yourself available for at least two days each week to apply yourself to these duties.

As compensation for the performance of these duties, you will be paid a salary, commencing on August 1, 1967, of $12,000 per year, payable in monthly installments of $1,000. In addition, you will receive reimbursement of all expenses reasonably incurred by you in the performance of your duties, upon presentation to Castle Rest of vouchers or other appropriate evidence of your expenditures.

(The Case for Dismissal — Group H) **
Exhibit H-8 — Employment contract for partner McKinney (5/1/67) with letter agreement covering treatment of salary as draw on profits (9/6/67).

Exh H-8

H-8/3

2

Your employment with Castle Rest will continue until August 31, 1968, but this term may be extended by mutual agreement between you and Castle Rest.

If the foregoing correctly expresses our understanding as to your employment by Castle Rest, please sign and return a copy of this letter to the undersigned, whereupon it shall become a binding agreement between us.

Very truly yours,

CASTLE REST NURSING HOME

By Thomas M Fahey
Thomas M. Fahey, a partner

The foregoing is accepted and agreed as of the date first above written:

Walker McKinney
Walker McKinney

(The Case for Dismissal — Group H) **
Exhibit H-9 — Employment contract for partner Simpson (5/1/67) with letter agreement covering treatment of salary as draw on profits (9/7/67).

Exh H-9

H-9 1 7/11

George A. Simpson, M.D.
592 Park Avenue
East Orange, New Jersey

September 7, 1967

Castle Rest Nursing Home
116 East Castle Street
Syracuse, New York 13205

Gentlemen:

This letter is to define my understanding that any salary paid to me pursuant to our Employment Agreement, dated May 1, 1967, shall apply against any share of profit distribution due me in accordance with the provisions of the Castle Rest Nursing Home Partnership Agreement.

George A. Simpson

GAS:m

cc: W. McKinney
T. Fahey
T. Metzger

(The Case for Dismissal — Group H) **
Exhibit H-9 — Employment contract for partner Simpson (5/1/67) with letter agreement covering treatment of salary as draw on profits (9/7/67).

Exh - H-9

H-9

CASTLE REST NURSING HOME
116 East Castle Street
Syracuse, New York

May 1, 1967

Dr. George A. Simpson
592 Park Avenue
East Orange, New Jersey 07017

Dear Dr. Simpson:

The purpose of this letter is to set forth the terms of the agreement between you and Castle Rest Nursing Home concerning your employment.

Castle Rest hereby agrees to employ you as its medical director. In this position, you will supervize the activities of Castle Rest's staff in establishing and maintaining medical procedures for the well-being of its patients, render such medical services of a supervisory nature as may be required while you are in Castle Rest's facilities, and perform such other duties of a similar nature as you are directed by Castle Rest. You will hold yourself available for at least two days each month to apply yourself to these duties.

As compensation for the performance of these duties, you will be paid a salary, commencing on August 1, 1967, of $2,400 per year, payable in monthly installments of $200. In addition, you will receive reimbursement of all expenses reasonably incurred by you in the performance of your duties, upon presentation to Castle Rest of vouchers or other appropriate evidence of your expenditures.

(The Case for Dismissal — Group H) **
Exhibit H-9 — Employment contract for partner Simpson (5/1/67) with letter agreement covering treatment of salary as draw on profits (9/7/67).

Exh H9 H-9/3

Your employment with Castle Rest will continue until August 31, 1968, but this term may be extended by mutual agreement between you and Castle Rest.

If the foregoing correctly expresses our understanding as to your employment by Castle Rest, please sign and return a copy of this letter to the undersigned, whereupon it shall become a binding agreement between us.

Very truly yours,

CASTLE REST NURSING HOME

By Thomas M. Fahey
Thomas M. Fahey, a partner

The foregoing is accepted and agreed as of the date first above written:

George A. Simpson
George A. Simpson

(Index of Trial Brief Exhibits — Trial Brief, 5/30/74).

RE: U.S. v. Thomas Fahey

Total Exhibits (By Group)

Group		No. of Exhibits
A	Partnership Agreement Documents	11
B.	Motion Papers Re Litigation (Court and Arbitration)	16
C	Fahey First Briefs in Arbitration	2
D	Specific Extracts from Record in Arbitration	3
E	Settlement Papers (Including Financing Documents)	16
F	Accounting Documents	3
G	Citations and Authorities	7
H	The Case for Dismissal	9

(Index of Trial Brief Exhibits — Trial Brief, 5/30/74)
Complete Index of all Trial Brief Exhibits (Groups A through H).

Re U.S. v. Thomas Fahey

GROUP A

Exhibit #	Partnership Agreement Documents		Arbitration Exhibits
A-1 11/23/64	First Partnership Agreement	- General Partnership	Ex. A; T109
A-2 1/4/65	Second Partnership Agreement	- Limited Partnership	Ex. E; T129
A-3 2/9/65	Amend to Second Agreement	- Capital Contribution	Ex. F; T145
A-4 11/16/65	Third Partnership Agreement	- General Partnership	Ex. G; T168
A-5 8/1/66	First Amend to Third Agreement	- Name Change	Ex. G; T168
A-6 9/1/67	Auxiliary Partnership Agreement for Home for Adults	- General Partnership	Ex. 2; T38
A-7 9/--/67	Letter Agreement to Amend Auxiliary Partnership Agreement dated 9/1/67	- General Partnership	Ex. 2; T32
A-8 11/5/68	Proposed Second Amend to third Agreement (1st draft) (partially signed)	- Proposed new partner Proposed new purchase option	Ex. SS; T35
A-9 1/5/69	Proposed Second Amend to third Agreement (2d draft) (Partially signed)	- Proposed new partner	Ex. 5; T32
A-10 3/12/69	Purchase Agreement Between Partners	- Fahey Purchase of Simpson Interest	Ex. WW; T5
A-11 3/25/69	Proposed Second Amend to Third Agreement (3rd draft) (signed without provision for Fahey's signature)	- New Partner (Jane McKinney)	Ex. 1; T385

(Index of Trial Brief Exhibits — Trial Brief, 5/30/74)
Complete Index of all Trial Brief Exhibits (Groups A through H).

GROUP B

Motion Papers Re Litigation
Court and Arbitration

EXHIBIT			
B-1	6/ 3/69	MOVING PAPERS (McKinney)	EX PARTE INJUNCTION
B-2	6/ 3/69	LETTER (McKinney)	MCKINNEY ATTEMPT TO EXPELL AND DISMISS FAHEY
B-3	6/20/69	DECISION (Aronson)	REFER DISPUTE TO ARBITRATION: DENY RESTRAINING ORDER
B-4	6/21/69	LETTER (McKinney)	MCKINNEY ATTEMPT TO BUY OUT FAHEY
B-5	6/23/69	ORDER DRAFT (Lawton for Aronson)	
B-6	6/23/69	ORDER (Aronson	REFER DISPUTE TO ARBITRATION: GROUNDRULES FOR INTERIM OPERATIONS
B-7	9/ 8/70	ARBITRATION AWARD	
B-8	10/ 1/70	MOTION (Fahey)	TO CONFIRM ARBITRATION AWARD
B-9	10/ 9/70	CROSS-MOTION (McKinney)	TO VACATE OR MODIFY AWARD
B-10	1/ 6/71	DECISION (Aronson)	MODIFYING AWARD
B-11	6/ 7/71	LETTER (Kemple)	ORDER DRAFT
B-12	2/16/72	ORDER (Aronson)	MODIFYING AWARD
B-13	3/ /72	NOTICE OF APPEAL (Fahey)	
B-14	3/20/72	CROSS-NOTICE OF APPEAL (McKinney)	
B-15	BRIEF	Millet v. Slocum 4 AD 2d 528, Aff'd 5 NY 2d 734 (1957). Partners cannot, as a matter of law, either expel a co-partner or compel him to resign or withdraw, on the ground that it is in the best interest of the partnership.	
B-16	NOTES	SEE NOTES RE ANOTHER ALTERNATIVE TO A STRAIGHT APPEAL TO OVERRULE ARONSON AND CONFIRM AWARD (which opposition has stated they would take to Court of Appeals). The object would be to affirm Fahey's continuing status as a partner and tie up assets of Castle Rest Nursing Home from dissipation by McKinney.	

(Index of Trial Brief Exhibits — Trial Brief, 5/30/74)
Complete Index of all Trial Brief Exhibits (Groups A through H).

Re U.S. v. Thomas Fahey

Group C

Fahey Final Briefs In Arbitration

Exh C-1	First Final Brief on behalf of Thomas Fahey
Exh C-2	Reply Brief on behalf of Thomas Fahey

(Index of Trial Brief Exhibits — Trial Brief, 5/30/74)
Complete Index of all Trial Brief Exhibits (Groups A through H).

RE: U.S. v. Thomas Fahey

GROUP D

Specific Extracts from Record in Arbitration

Extract	Items Covered in the Record
D-1 pp. 237-251	Specific offer made in January 1968 by taxpayer's partner to completely change partnership agreement and division of income. Offered to eliminate provisions on "depreciation", "losses", and "profit", including the "cummulative" on the capital account. Offered to eliminate everything and replace it with a straight 80%-20% split of "everything". Taxpayer did not accept on the ground the percentage was unfair since he was now claiming 45% of the "profits" under the agreement.
D-2 pp. 322-327	A year later, taxpayer's partner threatened to "end the partnership" over disagreements regarding certain disbursements - December 1968.
D-3 pp. 1222-1228	Taxpayer's partner asked minor partner (Simpson) to help him physically take over the business by locking the taxpayer out of his office at the meeting in January 1969, but the scheme was dropped. Simpson comments on attempts to resove the differences between the major partners. Sale of Simpson's interest to taxpayer.

RE: U.S. v. Thomas Fahey

GROUP E

Settlement Papers (Including Financing Documents)

Exhibit E-1 Oct./1972	General Release - To Thomas Fahey from Walker and Jane McKinney.
Exhibit E-2 10/20/72	Business Certificate - Thomas Fahey succession in interest to Walker McKinney and Jane McKinney.
Exhibit E-3 10/19/72	Bill of Sale - Personal property of nursing home sold to Castle Rest Facilities Corp. by Walker and Jane McKinney.
Exhibit E-4 10/19/72	Deed - Real property conveyed to Castle Rest Facilities Corp. by Walker and Jane McKinney.
Exhibit E-5 10/19/72	Closing Statements
Exhibit E-6 8/17/72	Agreement for Purchase and Sale of Business
Exhibit E-7 8/17/72	Agreement of Exchange of Realty
Exhibit E-8 8/17/72	Addendum to Agreements of Exchange of Realty and Purchase and Sale of Business
Exhibit E-9 10/19/72	Second Addendum to Agreements of Exchange of Realty and Purchase and Sale of Business
Exhibit E-10 7/28/72	Mortgage Commitment Letter from Rochester Savings Bank
Exhibit E-11 10/19/72	Mortgage Note with Rochester Savings Bank
Exhibit E-12 10/19/72	Mortgage (first part) with Rochester Savings Bank
Exhibit E-13 10/19/72	Mortgage (second part) with Rochester Savings Bank
Exhibit E-14 10/19/72	Lease of Real Property to Thomas Fahey from Castle Rest Facilities Corp.
Exhibit E-15 10/19/72	Assignment of Lessor's Interest in Lease to Rochester Savings Bank
Exhibit E-16 10/19/72	Personal Property Lease - To Thomas Fahey from Castle Rest Facilities Corp.

(Index of Trial Brief Exhibits — Trial Brief, 5/30/74)
Complete Index of all Trial Brief Exhibits (Groups A through H).

Re U.S. v. Thomas Fahey

Group F - Accounting Documents

Exh F-1 3/17/66	Letter of Instruction with U. S. Partnership Return for the year 1965, From Ernst & Ernst.
Exh F-2 2/14/67	Letter of Instruction with U. S. Partnership Return for the year 1966, From Ernst & Ernst.
Exh F-3 4/2/68	Letter of Instruction with U. S. Partnership Return for the year 1967, From Ernst & Ernst.

(Index of Trial Brief Exhibits — Trial Brief, 5/30/74)
Complete Index of all Trial Brief Exhibits (Groups A through H).

RE: U.S. v. Thomas Fahey

GROUP G

Citations and Authorities

Exhibit	
G-1	Aronsohn, Alan J. B., Partnerships and Income Taxes (1957, 1966, 1970), Practicing Law Institute - Effect of Partnership Agreement
G-2	Aronsohn, Alan J. B., Partnerships and Income Taxes (1957, 1966, 1970) - Depreciation or Depletion with Respect to Contributed Property
G-3	Willis, A. B., Willis on Partnership Taxation (1971), Section 4.02(a) - Sample Article Defining Capital Accounts and Drawing Accounts
G-4	Willis, A. B., Willis on Partnership Taxation (1971), Section 19.09 - Special Allocation of Depreciation
G-5	Willis, A. B., Willis on Partnership Taxation (1971), Section 19.12 - The Right of Other Partners to Challenge the Recognition of the Special Allocation for Income Tax Purposes
G-6	Case Law on the "Advice of Counsel" Defense. Prepared by defense counsel.
G-7	IRS Regulations Section 1.703-1 - Partnership Computations. (b) Elections of the partnership. (1) General rule.

(Index of Trial Brief Exhibits — Trial Brief, 5/30/74)
Complete Index of all Trial Brief Exhibits (Groups A through H).

Re: U.S. V. Thomas Fahey

Group H

The Case for Dismissal

H-1 Memorandum on "The Case for Dismissal".

H-2 Letter from accounting firm, Ernst & Ernst, for submittal to the U.S. Attorney.

H-3 Application for extension of time (until June 15, 1970) to file 1969 partnership return on grounds that distribution of partnership income is in arbitration - Dated 4/9/70.

H-4 Second application for extension of time (until 9/15/72) to file 1969 partnership return on same grounds - Dated 6/11/73.

H-5 Letter from partner's attorney stating "It has been impossible to complete financial statements" because of the arbitration. - Dated 6/30/70.

H-6 Copy of affidavit obtained by Special Agent from partner (Metzger) stating no other agreement "ever existed" between the partners except the one signed by him on 11/15/65 (with letter of transmittal from partner Metzger - Dated 6/28/71).

H-7 Chart prepared during arbitration showing the evolution of three partnership agreements, and the changes that took place, including the major changes in depreciation.

H-8 Employment contract for partner McKinney (5/1/67) with letter agreement covering treatment of salary as draw on profits (9/6/67).

H-9 Employment contract for partner Simpson (5/1/67) with letter agreement covering treatment of salary as draw on profits (9/7/67).

(Inter-Related Pre-Trial Items — pre-trial record & trial brief). Motion for Bill of Particulars; and Discovery and Inspection, including (1) Notice of Motion, and (2) Affidavit (Pre-trial record, 1/3/74).

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

C.R. No. 73CR 181

THE UNITED STATES OF AMERICA

v.

THOMAS M. FAHEY

VIO: Title 26, U.S.C. Section 7201

NOTICE OF MOTION FOR BILL OF PARTICULARS AND DISCOVERY AND INSPECTION

SIR:

PLEASE TAKE NOTICE that upon the annexed affidavit of Dante M. Scaccia, Esq., sworn to the 3rd day of January, 1974, at Syracuse, New York and the Indictment herein and upon all proceedings heretofore had herein, the undersigned will move this Court on the 14th day of January, 1974 for an Order directing the United States Attorney to file a bill of particulars and to allow discovery and inspection in the above entitled criminal proceeding as to the following items.

BILL OF PARTICULARS

(a) The particular items and amounts which the Government contends make up the difference between the taxable income reported (1966 -- $3,742.00), (1967 -- $7,707.00) and the alleged actual taxable amounts of income (1966 -- $18,245.50), (1967 -- $19,373.22), including.

(1) The specific items of gross income allegedly not reported, and the source or sources from which each item was derived, disclosing when, where, how, and by whom payment was made;

(2) The deductions and costs allowed and/or disallowed against such income;

(3) The manner and method by which the Government computed the income of Castle Rest Nursing Home (formerly Walker McKinney Associates), a partnership;

(4) The manner and method by which the Government computed the taxpayer's distributive share of said partnership income;

(5) Whether the Government computed the gross income of the taxpayer by adding to the gross income reported on the respective individual income tax returns the distributive share from the partnership;

(6) Whether the gross income computed by the Government was so computed under any particular section of the Internal Revenue Code and whether it was alleged to be derived from the partnership;

(7) The method by which the Government computed the source and individual amounts of income of the partnership;

(8) Whether the deductions which appear on the respective returns of the taxpayer were allowed by the Government in computing taxable income;

(9) Whether any deductions listed on the income tax returns filed by the taxpayer have been disallowed by the Government.

(b) Such other information as may be necessary to enable the defendant to determine the basis upon which the Government asserts an understatement of income in the amounts alleged, namely (1966 -- $14,994.00; 1967 -- $11,666.62).

DISCOVERY AND INSPECTION

(10) Produce and permit the defendant to inspect and copy or photograph any statements, books, papers, documents, or copies, or portions thereof, of any of such which were taken from the defendant, the partners, accountants, and/or lawyers for the partnership, or furnished by or on behalf of the defendant, the partners, accountants, and/or lawyers for the partnership to the Government, which are within the possession, custody or control of the Government;

(11) Discovery and inspection of the entire partnership accounting and tax treatment as against that of the individual partners to ascertain the manner and method of the tax treatment as well as the consistency of treatment.

(12) Discovery and inspection seeking information with respect to the presence of and information furnished by informants as well as the identity of same;

(13) Discovery and inspection of all books, records and accounts used by the Government in the prosecution of the case;

(14) Discovery and inspection of the special agent's report; and

FOR SUCH OTHER AND FURTHER RELIEF AS TO THE COURT MAY APPEAR JUST AND PROPER IN THE PREMISES.

Dated: January 3, 1974
Syracuse, New York

LOVE, BALDUCCI & SCACCIA

By: Dante M. Scaccia
DANTE M. SCACCIA
A Member of the Firm
Attorneys for Defendant
300 Wilson Building
306 South Salina Street
Syracuse, New York 13202
Tel No. 474-4603 Area Code 315

(Inter-Related Pre-Trial Items — pre-trial record & trial brief)
Motion for Bill of Particulars; and Discovery and Inspection, including (1) Notice of Motion, and (2) Affidavit (Pre-trial record, 1/3/74).

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

CR. NO. 73CR 181

THE UNITED STATES OF AMERICA

v.

THOMAS M. FAHEY

VIO: Title 26, U.S.C. Section 7201

AFFIDAVIT IN SUPPORT OF MOTIONS FOR BILL OF PARTICULARS: AND DISCOVERY AND INSPECTION

UNITED STATES OF AMERICA)
NORTHERN DISTRICT OF NEW YORK)
STATE OF NEW YORK) SS.:
COUNTY OF ONONDAGA)
CITY OF SYRACUSE)

DANTE M. SCACCIA, being duly sworn, deposes and says:

1. That he is the attorney for the defendant in the above entitled criminal proceeding.

2. Since the arraignment on December 10, 1973, the United States Attorney and the defense counsel have had several meetings and telephone conferences, which have all been conducted in a spirit of cooperation with the Court's indicated attitude toward informal pre-trial discovery of Government information on behalf of the defense.

3. Even before the beginning of these meetings, defense had in its possession documentary evidence which indicated to the defense 3 important conclusions

(a) that the theory of the Government's case was limited to a "specific items" case,

(b) that exculpatory evidence was in existence and was continuously available from the very outset of the investigation; and this was made known to the Government,

(c) that the Government had in its possession certain material affidavits which were on their face false statements regarding a significant element of the defendant's position.

4. An unprecedented pre-trial revelation to the Government of these significant defense conclusions and the evidence supporting them, was initiated voluntarily be defense counsel during a step-by-step process of cooperative exchange of information.

5. During this exchange, both counsels recognized that in this particular case, justice would best be served by a full and complete exchange of information by both sides.

6. The reason for this is that defense counsel has now confirmed his original conclusion that there is sufficient exculpatory evidence, and erroneous Government information, together with significant statements of law, to warrant and justify the conclusion that the taxpayer should not have been indicted and that the indictment should be dismissed.

7. The United States Attorney, on his part, has fully appreciated the disclosures revealed to him thus far, and wishes to see the balance of the case for the defense.

8. On the strength of what he has seen thus far, the United States Attorney has agreed to accept from the defense, after the exchange of the evidence, a full and complete presentation setting forth the grounds for dismissal of the indictment.

9. If the United States Attorney is convinced of the validity of the defense claims, and that it would not serve the interest of justice to prosecute the taxpayer, he will, after approval by the Department of Justice, join with defense in a motion to dismiss.

10. Both the United States Attorney and the defense counsel recognize that even though their agreed upon disclosure procedure goes somewhat beyond the practices recognized thus far in the limits of case law, it is considered to be consistent with the best interests of the Government, the taxpayer, and the Court.

11. Accordingly, both sides have agreed it would be wise, at this stage in the proceeding to obtain through this motion the

official sanction of the Court to continue the disclosure procedure to the point where the United States Attorney decides to dismiss or prosecute.

12. At this point, the defense has offered to reveal all of its evidence. The United States Attorney has agreed to reveal all of its evidence, without additional motions by defense -- with only 2 possible exceptions -- (1) the IRS Special Agent's Report, and (2) the name of the informer. Even access to these two exceptions were not refused outright by the United States Attorney. He merely took the position that because of the non-disclosure policy of IRS regarding these two items, he would prefer the defense made a separate motion to obtain them.

13. In the light of the willingness and cooperation shown thus far by both sides in furthering the disclosure policy of the Court, we respectfully request the Court for an Order to sanction our pursuing this matter to a very useful conclusion.

14. It is the plain sense of the amended Rule that discovery be broadened and a realistic effort, consonant with protection of the interests of both sides, should be made by lawyers for the Government and the defense handling criminal tax cases to respond in the spirit of the rule. Full use of the enhanced discovery privileges afforded both sides should benefit the process of fact finding.

15. As of the time of the preparation of this motion (Thursday 12:00Noon, January 3, 1974), the Government has been unable (for mechanical reasons only) to deliver to defense counsel copies of the information it has agreed to deliver.

16. In order to comply with the deadline of January 4, 1974 set by the Court for filing of discovery motions, this motion includes the items set forth in the notice of motion.

Subscribed and sworn to
before me this 3rd day
of January, 1974.

/s/

Dante M. Scaccia
DANTE M. SCACCIA

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(Inter-Related Pre-Trial Items — pre-trial record & trial brief).
Letter of transmittal from Defense Counsel to U.S. Attorney
(Pre-trial record, 1/28/74).

LOVE, BALDUCCI & SCACCIA
ATTORNEYS AT LAW

FRANK C. LOVE
RALPH J. BALDUCCI
DANTE M. SCACCIA

300 WILSON BUILDING
306 SOUTH SALINA STREET
SYRACUSE, NEW YORK 13202
474-4603
422-4000

January 28, 1974

United States Attorney
Federal Building
Syracuse, New York 13202

Attention: Eugene Welch, Esq.

Re: U.S. -v- Thomas Fahey
73 - CR - 181

Dear Sir:

Enclosed is a list of eight (8) groups of documents we are planning to submit to your office. The groups are identified by letters (A) through (H), and the documents we submit will be coded to their respective groups (Exhibit A-1, A-2, etc.)

Also enclosed is the list of documents we are submitting this date, together with a group checklist to indicate whether all the documents in the group have been submitted or whether the submittal is partial.

In subsequent submittals, we will also indicate the completion status of groups in the same manner.

We are also physically submitting the documents for each group in separate volumes for easier handling and reference.

Very truly yours,

Dante M. Scaccia

DMS:jmb
Encs.

COPY

(Inter-Related Pre-Trial Items — pre-trial record & trial brief)
Letter of transmittal from Defense Counsel to U.S. Attorney
(Pre-trial record, 1/28/74).

Re: U.S. v. Thomas Fahey

GROUPS OF DOCUMENTS TO BE SUBMITTED

Group A	-	Partnership Agreements
Group B	-	Motion Papers Re: Litigation (Court and Arbitration)
Group C	-	Fahey Trial Briefs in Arbitration
Group D	-	Specific Extracts from Record In Arbitration
Group E	-	Settlement Papers (Including financing documents)
Group F	-	Accounting Documents
Group G	-	Citations and Authorities
Group H	-	The Case for Dismissal

(Inter-Related Pre-Trial Items — pre-trial record & trial brief)
Letter of transmittal from Defense Counsel to U.S. Attorney
(Pre-trial record, 1/28/74).

Re: U.S. v. Thomas Fahey

DOCUMENTS SUBMITTED 1/28/74

Group Exhibits		Group Checklist
A-1 through A-11	Partnership Agreements	All Submitted
B-1 through B-16	Motion Papers Re: Litigation (Court and Arbitration)	All Submitted
C-1 through C-2	Fahey Final Briefs in Arbitration	All Submitted
E-1 through E-16	Settlement Papers (Including financing documents)	All Submitted
F-1 through F-3	Accounting Documents	Partial submittal

(Inter-Related Pre-Trial Items — pre-trial record & trial brief).
Letter of transmittal from Defense Counsel to U.S. Attorney
(Trial brief, 5/30/74).

4/1

Love, Balducci & Scaccia
Attorneys at Law

Frank E. Love
Ralph J. Balducci
Dante M. Scaccia

Richard J. Brickwedde

F-109 (15)

300 Wilson Building
306 South Salina Street
Syracuse, New York 13202
(315) 474-4603 - (315) 422-4000

May 30, 1974

United States Attorney
Federal Building
Syracuse, New York 13202

Attention: Eugene Welch, Esq.

Re: U. S. v. Thomas Fahey
73 CR 181
- - - - - - - - - - - - - -

Dear Sir:

Enclosed are the remaining documents that complete all the categories of information to be submitted (including the memorandum on the Case for Dismissal), that I listed in my letter of January 28, 1974.

The submittal includes a final total listing of all the documents submitted, by their respective groups.

Also enclosed for your use in any way that is helpful, in view of the current pressure of time, is a draft of a letter to the Department of Justice in Washington from the U. S. Attorney requesting authorization to join with defense counsel in a motion to dismiss the indictment.

Very truly yours,

LOVE, BALDUCCI & SCACCIA

By: Dante M. Scaccia
Dante M. Scaccia

DMS:rl
Enclosures

(Inter-Related Pre-Trial Items — pre-trial record & trial brief). Proposed Memorandum from the U.S. Attorney to the Department of Justice in Washington requesting authorization to dismiss the indictment, draft prepared by Defense Counsel for use by U.S. Attorney (Trial brief, 5/30/74).

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RE: UNITED STATES v. THOMAS M. FAHEY
CR. No. 73CR181
Indictment: Violation 28 U.S.C. §7201

MEMORANDUM

Supporting Request for Authorization

to Dismiss the Indictment

(Inter-Related Pre-Trial Items – pre-trial record & trial brief)
Proposed Memorandum from the U.S. Attorney to the Department of Justice in Washington requesting authorization to dismiss the indictment, draft prepared by Defense Counsel for use by U.S. Attorney (Trial brief, 5/30/74). W-1 5/

This is a request for authorization to join with defense counsel in a motion to dismiss the indictment in the case of United States vs Thomas M. Fahey (Criminal No 73CR181).

I strongly recommend dismissal. After examining all of the facts, evidence, and questions of law involved in the case, I have reached the definite conclusion that it would best serve the interest of the government and the taxpayer to dismiss the indictment.

I have reached this conclusion on the basis of voluminous new exhibits not available to this office at the time of the indictment.

After the indictment was handed down, I was surprised to discover that the taxpayer had never consulted legal counsel regarding this tax matter. He thereupon immediately brought the matter to the attention of Dante M. Scaccia Esq. who was on retainer to the taxpayer for legal matters pertaining to his business, and consequently was intimately familiar with the entire partnership dispute that is directly related to the taxpayer's tax problem.

Mr. Scaccia, after consulting with the taxpayer and reviewing all the partnership records available to him, immediately brought to my attention several significant items of evidence and information which could substantiate dismissal of the case.

After discussing these items, we entered into an informal agreement, in the interest of justice and with the awareness of

(Inter-Related Pre-Trial Items — pre-trial record & trial brief)
Proposed Memorandum from the U.S. Attorney to the Department of Justice in Washington requesting authorization to dismiss the indictment, draft prepared by Defense Counsel for use by U.S. Attorney (Tria. brief, 5/30/74).

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the Court, for a voluntary exchange of information upon request. Subsequently, I delivered certain documents requested by Mr. Scaccia. On his part, Mr. Scaccia volunteered to organize and deliver to me, and did deliver, all of the evidence and information supporting the taxpayer, together with an appropriate memorandum setting forth the entire theory and arguments of the defense, to fully substantiate a recommendation for dismissal.

Mr. Scaccia submitted a total of 67 exhibits, 48 of them on 1/28/74.

My recommendation for dismissal, therefore, is based on a review of the entire evidence and information involved in the case.

The indictment charges the taxpayer with violation of the revenue code (26 U.S.C. Section 7201). The indictment alleges the taxpayer knowingly attempted ". . . to evade and defeat . . . " a part of the income tax due for the calendar years 1966 and 1967.

After a complete examination of the case, I have found that the evidence does not support the charge of evasion. In fact there is a considerable amount of evidence that actually points to the absence of intent to evade.

There is even a questionof whether the alleged "income" reserved by the taxpayer as a partner of a nursing home is taxable at all. This question exists because of the complexities of partnership accounting law, and because there was a bitter

(Inter-Related Pre-Trial Items -- pre-trial record & trial brief)
Proposed Memorandum from the U.S. Attorney to the Department of Justice in Washington requesting authorization to dismiss the indictment, draft prepared by Defense Counsel for use by U.S. Attorney (Trial brief, 5/30/74).

W-3 5/4

dispute amongst the partners over the computation and division of profits which culminated in litigation that lasted over 3 years (from June 1969 to October 1972).

The evidence shows that the litigation ended on October 19, 1972. On that date, the taxpayer purchased the entire nursing home business from his former partner, and they both agreed to end the litigation as a condition of the purchase and sale.

The taxpayer has submitted considerable evidence to demonstrate the complexity of the dispute between the taxpayer and his partner regarding the computation and division of partnership profits.

The evidence shows that the dispute involved the interpretation of all the provisions of the partnership agreement affecting the net income of the partners, including the key element of "depreciation" allocations to the partners. The partners were diametrically opposed in their interpretations of the meaning and application of these provisions.

Defense Counsel urges very strongly, and with a great deal of merit, that because of the complexity of the controversy and the rules of partnership accounting, neither the taxpayer nor the IRS Special Agent really knew the full legal and accounting significance of what they were talking about during their conversations when they used the terms "depreciation," "losses," "draw," "agreements," etc. Defense counsel illustrates

(Inter-Related Pre-Trial Items — pre-trial record & trial brief)
Proposed Memorandum from the U.S. Attorney to the Department of Justice in Washington requesting authorization to dismiss the indictment, draft prepared by Defense Counsel for use by U.S. Attorney (Trial brief, 5/30/74). W-4

his point by referring to the actual memoranda of the conversations written by the Special Agent.

By not fully understanding the situation, defense counsel points out, the Special Agent went out and rounded up affidavits from the other partners which merely documented one side of the dispute between the partners. This is hardly and kind of "evidence" at all, defense counsel points out.

This lack of understanding, defense counsel urges, resulted in a completely inadequate and erroneous investigation of the case by the Special Agent.

It also caused the introduction of two special elements into the case which defense counsel points out, and with which I concur, lend a touch of "undesirable flavor" to the case with respect to the position of the Government.

One of these elements is that the IRS Special Agent obtained from one of the taxpayer's former partners an affidavit that was false on its face regarding an important fact that was directly material to the taxpayer's position. This affidavit was later modified to some extent, but its existence would be very embarrassing to the government.

The other element is that the investigation of the taxpayer originated in the criminal division, not as a result of an audit by the civil division, but at the urging of a person acting for the partner against whom the taxpayer was engaged in the litigation, and with whose attorney the special

(Inter-Related Pre-Trial Items — pre-trial record & trial brief)
Proposed Memorandum from the U.S. Attorney to the Department of Justice in Washington requesting authorization to dismiss the indictment, draft prepared by Defense Counsel for use by U.S. Attorney (Trial brief, 5/30/74). w-5

agent had numerous contacts, without having any contacts with the taxpayer's attorney in the litigation.

While these two "undesirable elements" are not directly probative one way or another, they introduce an atmosphere of "unfairness" which would certainly have a strong effect in favor of the taxpayer.

There is another special element in the case relating to the "attitude" of the taxpayer which defense counsel characterizes as having a clearly "positive" effect in favor of the taxpayer, and which counsel argues can be construed as evidence of the absence of intent to evade.

The evidence shows that when the accounting firm Ernst & Ernst was first engaged in 1966 they found the bookkepper had been withholding State and Federal taxes fromthe money drawn by the taxpayer, in accordance with specific instructions to do so from a prior accounting firm. When Ernst & Ernst discovered this, they instructed the taxpayer to stop the withholding, which he did so, again following instructions from the accountants. This is a clear example, defense counsel argues, that shows the taxpayers basic conduct as being one of strictly following the instructions of professional accountants paid to provide these instructions in matters in which the taxpayer was not professionally knowledgeable.

There is also no "concealment" in this case in the ordinary sense of unexposed funds. In fact, the most basic charge of the IRS can be completely turned around in favor of the taxpayer. The specific amounts which the taxpayer did not include

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on his personal returns for 1966 and 1967 are clearly identified on the "declaration" made by the taxpayer to the government on the U. S. Partnership returns, and the taxpayer strongly claims that this open "declaration" by the taxpayer to the government by itself automatically precludes any possible charge of intent to evade.

The taxpayer also stands on the specific instructions that accompanied the U. S. Partnership returns which were prepared by the accounting firm of Ernst & Ernst. (This was new evidence provided by the taxpayer.)

The taxpayer's "income" in question was listed on the returns as an item separate from the "ordinary income" column. The instructions specifically direct the partners to transfer to their personal returns only the amounts shown in the "ordinary income" column. The taxpayer contends he has an absolute right to rely on these instructions.

What apparently raised a basic question for the IRS was that the taxpayer did list these items on his later 1968, 1969, and 1970 returns, giving the plausible reason that in view of the mounting bitterness and impending litigation with his partner, (which actually erupted less than 3 months after filing the 1968 return) he was therefore exercising the most extreme caution possible, because it might look "peculiar" if his personal returns showed no income at all. (In 1966 and 1967, the taxpayer had other employment income to enter on his returns.)

(Inter-Related Pre-Trial Items — pre-trial record & trial brief)
Proposed Memorandum from the U.S. Attorney to the Department of Justice in Washington requesting authorization to dismiss the indictment, draft prepared by Defense Counsel for use by U.S. Attorney (Trial brief, 5/30/74). W-7 5/8

In the light of all the circumstances involved, even though the bare personal returns do raise the question of possible intent to evade for the years 1966 and 1967, it clearly appears from all the other evidence in the case that the taxpayer simply exercised poor and uninformed judgement in the handling of his personal returns regarding the items in question. He also exercised poor judgement in not obtaining accounting and/or legal counsel to advise him on how to relate this matter to the IRS.

Since I have found no other clear evidence of intent to evade, it would certainly not serve the interests of justice to prosecute the taxpayer for exercising poor and uninformed judgement in dealing with the IRS.

When this matter reaches the civil side of the IRS, and possibly the tax court, it is possible the taxpayer may end up owing no tax at all, if his legal contentions regarding partnership accounting are upheld.

The defense counsel has presented arguments, based on the IRS Regulations (Section 1.703-1 Partnership computation, (b) Elections of the Partnership), to the effect that the accounting firm should have treated the amounts in question as a "draw" in the same manner as it reated identical types of "draws" of the other partners, namely -- as a "debit" on the taxpayer's "capital account" rather than as a "deducation" to the partnership

(Inter-Related Pre-Trial Items — pre-trial record & trial brief)
Proposed Memorandum from the U.S. Attorney to the Department of Justice in Washington requesting authorization to dismiss the indictment, draft prepared by Defense Counsel for use by U.S. Attorney (Trial brief, 5/30/74). W-8 5/9

The consequence to the taxpayer of the application of this regulation alone, without regard to any other considerations, would be that none of the amounts he received as a draw would be considered "taxable income" for all the years 1965 through 1970.

In addition, defense counsel argues, the manner in which the litigation was ended -- by purchase rather than by resolution of the issues in court -- still preserves for the taxpayer all the valid legal tax arguments he can assert to the IRS against the one-sided "depreciation" and "losses" provisions of the partnership agreement, as being "contrary to public policy" and "not serving an economic purpose."

He can still assert these arguments, defense counsel argues, even though they are directly inconsistant with the "trial strategy" of the litigation which required the taxpayers to insist on the literal enforcement of the one-sided depreciation provisions of the partnership agreement, in the expectation that if the taxpayer was upheld, it would have produced an economic result so undesirable for his partner that he would have little choice but to agree to either a "normal" re-alignment of the "depreciation" and "losses" or sell out his interest.

The factual basis for this strong "trial strategy," defense counsel points out, is based on the actual specific offer that had already been made by the taxpayer's partner (in January 1968) to wipe out all the provisions of the agreement covering "depreciation," "losses," and "cumulative

(Inter-Related Pre-Trial Items — pre-trial record & trial brief)
Proposed Memorandum from the U.S. Attorney to the Department of Justice in Washington requesting authorization to dismiss the indictment, draft prepared by Defense Counsel for use by U.S. Attorney (Trial brief, 5/30/74). W-9

profits" and to replace them with a straight 80%-20% split of everything -- which the taxpayer had refused on the basis of unfairness, since he was already claiming a 45% interest in profits under the agreement. (Defense counsel has provided direct evidence to verify the offer in the form of a 14-page extract from the arbitration proceedings.)

In any event, it clearly appears that the civil side, rather than the criminal side, of the IRS is the proper forum for this case to analyze and determine the true taxable income of the taxpayers from the partnership for the years 1965 through 1970.

Looking at the entire case in terms of where "intent to evade" falls on the probability scale, it appears from all the evidence that it falls somewhere in the lower half of the scale. To put it conversely, all the evidence shows that the probability of establishing "intent to evade" beyond a reasonable doubt is minimal.

Under these circumstances, the case must be dismissed.

(Government Trial Brief, Dated 6/5/74).
Government Trial Brief (Received by Defense 6/6/74).

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA	
VS	CRIMINAL NO. 73-CR-181
THOMAS M. FAHEY	

GOVERNMENT'S TRIAL MEMORANDUM

JAMES M. SULLIVAN, JR.
United States Attorney for the
Northern District of New York
Federal Building
Syracuse, New York 13201

EUGENE WELCH, Assistant U. S. Attorney
Of Counsel

In an effort to assist the Court in familiarizing itself with this case in preparation for trial the government submits this memorandum.

PRELIMINARY STATEMENT

On November 12, 1973 the defendant Thomas M. Fahey of Syracuse, N. Y., was indicted on two counts of attempted tax evasion for the years 1966 and 1967, in violation of 26 U.S.C. 7201. He was arraigned on December 10, 1973 and entered a not guilty plea. On December 28, 1973 at the request of defense counsel, Dante M. Scaccia, a meeting was held in the office of the United States Attorney in Syracuse, New York to discuss the defense contentions that the government should dismiss the indictment and to discuss the government and defense evidence.

At that meeting the defense attorney was apprised of the government's method of proof, specific items. The defense contended that the government should dismiss because the investigation did not include areas which the defense felt demonstrated that the specific items involved were not taxable income. It should be noted that defense attorney Scaccia apparently did not represent Mr. Fahey during the IRS investigation. At the meeting the defense was unable to satisfactorily

explain this position; and it was therefore agreed that both sides would provide the other with its relevant documentation.

On January 3, 1974 the government provided Mr. Scaccia with copies of his client's statements as well as statements of Mr. Fahey's partners.

On January 14, 1974 the defendant waived his speedy trial rightsuntil the Auburn trial term to enable his counsel to prepare his documentation as to why this case should be dismissed. On January 28, 1974 Mr. Scaccia submitted some of the documents on which he relied with the specific promise of submitting complete documentation and a brief for dismissal in time for the United States Attorney to review and if appropriate, seek authorization to dismiss before the Auburn trial term. Continued contact with the defense attorney produced no brief, however, because the defense indicated they were too busy to do such a brief as a result of a thorough examination of the defendant's nursing home by state authorities.

Finally, on May 30, 1974 Mr. Scaccia did submit the remaining documentation and a brief in support of his request that the government dismiss this indictment. After reviewing these materials the government concluded that his position was without merit and

that the prosecution must continue. It is based upon these discussions and this brief that the government forsees the issues discussed in the remainder of this memorandum.

OFFENSES CHARGED

Count I charges that Mr. Fahey wilfully attempted to evade and defeat a large part of the tax due and owing by him for the calendar year 1966, by filing a false and fraudulent return wherein he stated his taxable income was $3,742.00 and the amount of tax due was $419.00, whereas his true taxable income was $18,245.50, upon which he owed a tax of $4,588.38. The date charged in Count I is the same date as charged in Count II, April 15, 1968, because the proof will show that he filed his 1966 return on the same day as his 1967 return, a year late.

Count II charges the same kind of offense but as to the calendar year 1967, wherein the reported taxable income was $7,707.00 with a reported tax due of $1,324.00, whereas the true taxable income was $19,373.22 and the true tax due was $4,204.50. Count II involves a joint return of Thomas M. and Carol P. Fahey. Count I involves Fahey's individual return.

SUMMARY:

	TAXABLE INCOME		
Year	Per Return	Corrected	Increases
1966	$ 3,742.00	$18,245.50	$14,503.50
1967	7,707.00	19,373.22	11,666.22
Totals	$11,449.00	$37,618.72	$26,169.72

	INCOME TAX LIABILITY		
Year	Per Return	Corrected	Deficiency
1966	$ 419.00	$ 4,588.38	$ 2,381.80 */
1967	1,324.00	4,204.50	2,880.50
Totals	$ 1,743.00	$ 8,792.88	$ 5,262.30

*/ The additional tax due and owing for 1966 is not computed by merely subtracting the reported tax due from the corrected tax due since the reported tax due in 1966 did not consider the sum of $1,595.00 which was withheld from Mr. Fahey's partnership salary. Although Mr. Fahey did not report this $1,595.00 withheld from his partnership salary, it is tax that he has paid and is considered in the computation of the actual additional tax due and owing for 1966.

The above summaries are computed as follows:

1966:

Taxable Income Per Return		$ 3,742.00
Increase or (Decrease) to Income:		
a) Unreported Gross Salary	$14,994.00	
b) N. Y. State Income Tax Withheld but not previously deducted	(490.50)	
Net Increase to Income		14,503.50
Corrected Taxable Income		$18,245.50

COMPUTATION OF INCOME TAX

Corrected Taxable Income	$18,245.50	
Tax on $18,000 (Head of the Household)	18,000.00	= 4,500.00
Excess at 36%	245.50	= 88.38
Corrected Tax Liability		4,588.38
Less:		
a) Federal Income Tax Withheld by Culotti Construction Co., Inc. and shown on tax return:	1,689.00	
b) Federal Income Tax Withheld by Walker McKinney Associates but not shown on tax return	1,595.00	
Sub Total	3,284.00	
c) Less: Amount refunded totaxpayer	(1,077.42)	
Total Tax Paid		2,206.58
Net Additional Tax Due		$ 2,381.80

1967:

Taxable Income Per Return		$ 7,707.00
Increase or (Decrease) to Income		
a) Unreported Gross Salary	$ 11,666.22	
Net Increase to Income		11,666.22
Corrected Taxable Income		$ 19,373.22

COMPUTATION OF INCOME TAX

Corrected Taxable Income	$ 19,373.22	
Tax on $16,000.00 (Joint Tax Return)	16,000.00 =	3,260.00
Excess at 28%	3,373.22 =	944.50
Corrected Tax Liability		$4,204.50

Less:

a) Federal Income Tax Withheld by Knudsen & Associates, Inc., (wife's employer).	320.80	
b) Federal Income Tax Withheld by Dey Brothers & Co., (wife's employer)	990.24	
c) Federal Income Tax Withheld by R. A. Culotti Construction Co.,Inc.	360.00	
d) Excess F.I.C.A. withheld	54.91	
Sub Total (rounded)	1,726.00	
e) Less: Amount of Tax Refunded	(402.00)	
Total Tax Paid		1,324.00
Net Additional Tax Due		$2,880.50

METHOD OF PROOF

As can be seen from the above computations there was $14,994.00 of unreported gross income in 1966 and $11,666.22 of unreported gross income in 1967. These are specific items and consist entirely of Mr. Fahey's unreported salary from a partnership called the Walker McKinney Associates partnership in 1966 and the Castle Rest Nursing Home partnership in 1967.

The government expects the proof to show that Mr. Fahey was a partner with Walker McKinney, Dr. George Simpson and Theodore Metzger in the operation of Castle Rest Nursing Home. The name of the partnership was changed on several occasions but the partners remained the same.

Pursuant to the Articles of Partnership signed by all the partners in November 1965, Mr. Fahey was to receive $20,000. per year salary to act as the administrator of the nursing home. He contributed no capital to the partnership as did the other partners.

As administrator, Mr. Fahey signed the partnership returns for 1966 and 1967 which clearly reflect he was paid a salary as stated above. On his individual income tax return for 1966 and 1967 he did not report this salary. Also, Mr. Fahey drew checks on the partnership account payable to himself, which checks, along with the Federal and State tax withheld in 1966, total the above unreported gross income. (The government is in possession of photocopies of these cancelled checks, the originals of which are in Mr. Fahey's possession as

present sole proprietor of the nursing home, having bought out the remaining partnership interests in the nursing home). Although the unreported salary is not the $20,000 guaranteed in the Articles of Partnership, the difference is made up by wages paid to Mr. Fahey in 1966 and 1967 by Culotti Construction Co. which wages he did report. The proof will show that Culotti Construction, which was doing the renovation of the nursing home during the years in question, by arrangement with Walker McKinney Associates was paying Mr. Fahey as a consultant.

The government's method of proof, therefore, will be to prove these specific items of unreported income from the partnership.

ISSUES OF LAW AND FACT

In the defense attorney's brief, discussed in the PRELIMINARY STATEMENT above, the defense raised numerous issues which, with one exception, are irrelevant. With the one exception concerning an alleged defense of reliance on the advice of counsel, the government will object to any questions on cross-examination by defense counsel or any offer of proof by defense counsel concerning these issues. It is the government's position that these issues are patently irrelevant and will be raised by the defense for the sole purpose of confusing the jury, leading the jury into trials within the trial in an attempt to cause unfounded confusion and doubts. This memo will treat each of these issues in the order raised in defense counsel's brief.

ATTACK ON THE SPECIAL AGENT

Point I of the defense brief alleges that the IRS special agent did not conduct a fair and impartial investigation but was motivated by Mr. Fahey's partners who, at the time of the IRS investigation were engaged in a bitter dispute with Mr. Fahey which involved litigation and arbitration. The government submits this is irrelevant since the evidence against Mr. Fahey is primarily documentary and the defense is merely attempting to put the agent on trial since it cannot impeach the documentary evidence.

ATTEMPT TO TREAT SIX TAX YEARS AS ONE

In his brief, as a preliminary statement in point II, which point contains Mr. Fahey's alleged defenses, in this preliminary statement to point II, Mr. Scaccia alleges that the years 1965 through 1970, during which Mr. Fahey was involved in the partnership, should be treated as one for tax purposes. This is clearly incorrect since each and every tax year must stand on its own. The law is clear that each year is a separate offense. See, for example, United States v. Sullivan, 98 F.2d 79 (2d Cir. 1938) or United States v. Smith, 335 F.2d 893 (7th Cir. 1964).

In addition, Mr. Scaccia argues that there was controversy in the partnership affecting such things as "draws" and "capital accounts." Nowhere in the voluminous minutes of the arbitration involving this partnership, nor anywhere in the Articles of Partnership, was Mr. Fahey entitled to any "draws" or "capital accounts". It is clear that at no time did Mr. Fahey make any capital contribution to this partnership. The Articles of Partnership specifically state that Mr. Fahey was to receive a salary of $20,000. a year which was to be treated as an expense to the partnership. At best, the lengthy arbitration and resulting litigation would have resulted in Mr. Fahey's receiving a higher

net income than he reported, or with which the government has charged him. The arbitration, however, did not end with a final ruling but was in an appeal status when Mr. Fahey settled the matter with the remaining partner, Mr. Walker McKinney. It should be noted that any discussion of the arbitration is irrelevant to the issues on trial in this case since the arbitration did not deal with the years herein in question, 1966 and 1967. The subject of subsequent discussion and arbitration is irrelevant because even if Mr. Fahey had eventually been awarded a tax benefit of some carry-back loss (which he was not), this loss could not be carried back to offset the unreported income in the prosecution here, as a subsequent loss "abates the [civil] deficiency but not the [criminal] penalty", Willingham v. United States, 289 F.2d, 283 (5th Cir. 1961). In a case involving litigation concerning amounts a corporation earned, the Fifth Circuit has indicated the outcome of subsequent litigation cannot be relied on to determine the outcome of the criminal fraud case, Bernstein v. United States, 234 F.2d 475 (5th Cir. 1956). It is important to realize that what counts in the criminal fraud case is not what the taxpayer might have done but what he actually tried to do. It is the situation at the time of the offense that controls, not ante or post. Support for this can be

found in the language of United States v. Spies, 317 U.S. 492 (1943), by United States v. Campbell, 351 F.2d 336 (2nd Cir. 1965). Therefore, it is submitted that what took place during the arbitration proceedings is irrelevant and should not enter into this trial except insofar as sworn testimony given in the arbitration proceedings by the witnesses in this case, or the defendant, is inconsistent with sworn testimony during the trial of this matter. Such inconsistencies certainly can be considered to test their credibility.

ADVICE OF COUNSEL DEFENSE

In point II of his brief, Mr. Scarcia sets out what he contends are five lines of defense.

The first line has to do with an allegation that Mr. Fahey followed the advice of counsel, his accountant, in filing his individual income tax return in failing to include therein his salary from the partnership. This defense is the only one that appears to have merit on its face and the government submits is the only one that should be decided by the jury. Certainly, if a defendant can establish that he, in good faith, relied and acted upon the advice of an attorney or accountant, or other qualified advisor, in doing or refraining from doing

an act made criminal if "wilfully" committed, such a defendant has made out a valid defense. See United States v. Phillips, 217 F.2d 435 (7th Cir. 1954); Benetti v. United States, 97 F.2d 263 (9th Cir. 1938); United States v. McCormick, 67 F.2d 867 (2nd Cir. 1933); cert. den., 291 U. S. 662; Lisansky v. United States, 31 F.2d 846 (4th Cir. 1929), 279 U.S. 873; United States v. Clayton-Kennedy, 2 F.Supp. 233 (D. Md. 1933); Bursten v. United States, 395 F.2d 976 (5th Cir. 1968); United States v. Platt, 435 F.2d 789 (2nd Cir. 1970).

But there are more important qualifications to this defense. The government should be allowed to demonstrate that the defendant may have received advice and not followed it. Barrow v. United States, 171 F.2d 286 (5th Cir. 1948); Hill v. United States, 363 F.2d 176 (5th Cir. 1966); Frohmann v. United States, 380 F.2d 832 (8th Cir. 1967), cert. den., 389 U.S. 976; United States v. Berkman, 302 F.Supp. 1285, aff'd 418 F.2d 212 (2nd Cir. 1969), cert. den. 396 U.S. 1014. In addition, all the facts concerning the taxpayer's income must be disclosed to the advisor, United States v. Cox, 348 F.2d 294 (6th Cir. 1965).

In the case of Mr. Fahey, there is a real question of fact as to what advice the accountant provided to Mr. Fahey; as to whether the accountant was Mr. Fahey's individual advisor; as to whether Mr. Fahey followed all of the

accountant's advice. The defense attorney in this case is relying entirely on one paragraph in a transmittal letter from the partners' accountant to Mr. Fahey. That letter was transmitting the partnership returns to Mr. Fahey as administrator. It discusses one particular item on the partnership return and its effect on the individual returns of the partners but does not discuss all the items on the partnership return, nor does it give Mr. Fahey advice.

In his brief the defense attorney himself admits that in the subsequent years 1968, 1969, Mr. Fahey deliberately ignored this alleged advice. This, then, will be an issue for the jury to decide.

FILING OF PARTNERSHIP RETURN BY MR. FAHEY HAS CONSTITUTED AN OFFICIAL REVELATION

Mr. Scaccia argues that since Fahey filed the partnership return for the years 1966, 1967, on which his salary was clearly represented, that he has thereby made an official revelation to the government of his income and therefore is not guilty of any fraud for concealing income. This position, however, ignores the fact that it is the responsibility of an individual taxpayer to report his total income and tax due on an

individual return. Disclosure of the partnership return was not his personal disclosure, but the partnership's disclosure. The partnership return does not disclose the tax Mr. Fahey, as an individual, owes.

INCOME IN QUESTION AS AN UNRESOLVED ELEMENT IN THE PARTNERSHIP DISPUTE

Apparently in furtherance of his preliminary statement to point II, Mr. Scaccia argues in this alleged third line of defense that since the dispute involved the computation and division of that income of the partners there must be a question as to the certainty of the tax due and owing for the years in question, as well as Mr. Fahey's intent to defraud. This position, however, ignores the fact that the subsequent litigation can have no effect on these tax years. Assuming that Mr. Fahey was entitled to some loss as a result of the arbitration, the Internal Revenue Code allows him to carry this back to only three years and this it would have no effect on the tax years in question. In any event, Mr. Fahey's position in the arbitration was that he was to have a 45% interest in the profits. Even if this position were correct, it would result in Mr. Fahey's having a greater income than that for which he is charged. And, finally, it can not be disputed that there is a definite tax due and owing for the years 1966, 1967 which remains unaffected by the subsequent arbitration.

ALLEGATION THAT TRUE TAXABLE INCOME OF THE TAXPAYER REMAINS IN QUESTION

This fourth line of defense alleged by Mr. Scaccia argues that since the settlement of the dispute, the actual taxable income to Mr. Fahey is still in question and must be analyzed by tax experts. Once again, this defense ignores the fact that the tax years 1966, 1967 were unaffected by the arbitration and must be judged as to Mr. Fahey's intent at the time that he filed the alleged fraudulent returns.

MISREADING OF INTERNAL REVENUE REGULATIONS

As a fifth line of defense, Mr. Scaccia cites I.R.S. Regulation 1.703-1(b), copy of which is attached to this memorandum.

Mr. Scaccia cites this regulation for the proposition that since partners Dr. Simpson and Walker McKinney had received "draws" which were not expenses of the partnership but "draws" against the capital account of these two partners, then as a result of the cited regulation, Mr. Fahey's salary should also be treated as a "draw" and not as an expense of the partnership.

Mr. Scaccia reads subsection (b) as saying any elections affecting the computation of income must be equal for all partners. Clearly the regulation does

not state that; rather, it states that whatever elections are made by the partnership are binding on all partners.

Consequently, partner McKinney, in this instance, could not be allowed to consider Mr. Fahey's salary as something other than an expense to the partnership, since the Articles of Partnership, signed by all the partners, elected to treat Mr. Fahey's salary as precisely that, a salary at an expense to the partnership for the purposes of the partnership's return. Consequently, all partners must treat it as such.

It is the position of the government that any reference to this particular regulation as interpreted by Mr. Scaccia in his brief, is incorrect, misleading, and irrelevant.

CONCLUSION

These are but a few of the potential questions that will arise during this trial. It is anticipated that, as stated above, the government will voice objections to many of these matters as simply efforts to confuse the jury.

Respectfully submitted,
JAMES M. SULLIVAN, JR.
United States Attorney for the
Northern District of New York

By: 
Eugene Welch
Assistant U. S. Attorney

June 5, 1974
Syracuse, N. Y.

(Government Trial Brief, Dated 6/5/74)
Government Trial Brief (Received by Defense 6/6/74).

regarded as having stated in his return only $1,500 ($300/$500 of $2,500) as gross income from the partnership.

(d) *Partners in community property States.* If separate returns are made by a husband and wife domiciled in a community property State, and only one spouse is a member of the partnership, the part of his or her distributive share of any item or items listed in paragraph (a) (1) through (9) of this section which is community property, or which is derived from community property, should be reported by the husband and wife in equal proportions.

[T.D. 6500, 25 F.R. 11814, Nov. 26, 1960, as amended by T.D. 6605, 27 F.R. 8097, Aug. 15, 1962; T.D. 6777, 29 F.R. 17809, Dec. 16, 1964; T.D. 6885, 31 F.R. 7808, June 2, 1966; T.D. 7192, 37 F.R. 12949, June 30, 1972]

§ 1.702–2 Net operating loss deduction of partner.

For the purpose of determining a net operating loss deduction under section 172, a partner shall take into account his distributive share of items of income, gain, loss, deduction, or credit of the partnership. The character of any such item shall be determined as if such item were realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership. See section 702(b) and paragraph (b) of § 1.702–1. To the extent necessary to determine the allowance under section 172(d)(4) of the nonbusiness deductions of a partner (arising from both partnership and nonpartnership sources), the partner shall separately take into account his distributive share of the deductions of the partnership which are not attributable to a trade or business and combine such amount with his nonbusiness deductions from nonpartnership sources. Such partner shall also separately take into account his distributive share of the gross income of the partnership not derived from a trade or business and combine such amount with his nonbusiness income from nonpartnership sources. See section 172 and the regulations thereunder.

§ 1.703 Statutory provisions; partnership computations.

SEC. 703. *Partnership computations*—(a) *Income and deductions.* The taxable income of a partnership shall be computed in the same manner as in the case of an individual except that—

(1) The items described in section 702 (a) shall be separately stated, and

(2) The following deductions shall not be allowed to the partnership:

(A) The standard deduction provided in section 141,

(B) The deductions for personal exemptions provided in section 151,

(C) The deduction for taxes provided in section 164 (a) with respect to taxes, described in section 901, paid or accrued to foreign countries and to possessions of the United States,

(D) The deduction for charitable contributions provided in section 170,

(E) The net operating loss deduction provided in section 172, and

(F) The additional itemized deductions for individuals provided in part VII of subchapter B (sec. 211 and following).

(b) *Elections of the partnership.* Any election affecting the computation of taxable income derived from a partnership shall be made by the partnership, except that the election under section 901, relating to taxes of foreign countries and possessions of the United States, and any election under section 615 (relating to pre-1970 exploration expenditures) or under section 617 (relating to deduction and recapture of certain mining exploration expenditures), shall be made by each partner separately.

(Sec. 703 as amended by sec. 3(b), Act of Sept. 12, 1966 (Public Law 89–570, 80 Stat. 762); sec. 504(c)(3), Tax Reform Act 1969 (83 Stat. 487))

[T.D. 6500, 25 F.R. 11814, Nov. 26, 1960, as amended by T.D. 7192, 37 F.R. 12949, June 30, 1972]

§ 1.703–1 Partnership computations.

(a) *Income and deductions.* (1) The taxable income of a partnership shall be computed in the same manner as the taxable income of an individual, except as otherwise provided in this section. A partnership is required to state separately in its return the items described in section 702 (a) (1) through (7) and, in addition, to attach to its return a statement setting forth separately those items described in section 702 (a) (8) which the partner is required to take into account separately in determining his income tax. See paragraph (a) (8) of § 1.702–1. The partnership is further required to compute and to state separately in its return:

(i) As taxable income under section 702 (a) (9), the total of all other items of gross income (not separately stated) over the total of all other allowable deductions (not separately stated), or

(ii) As loss under section 702 (a) (9), the total of all other allowable deductions (not separately stated) over the total of all other items of gross income (not separately stated).

The taxable income or loss so computed shall be accounted for by the partners in accordance with their partnership agreement.

(2) The partnership is not allowed the following deductions:

(i) The standard deduction provided in section 141.

(ii) The deduction for personal exemptions provided in section 151.

(iii) The deduction provided in section 164 (a) for taxes, described in section 901, paid or accrued to foreign countries or possessions of the United States. Each partner's distributive share of such taxes shall be accounted for separately by him as provided in section 702 (a) (6).

(iv) The deduction for charitable contributions provided in section 170. Each partner is considered as having paid within his taxable year his distributive share of any contribution or gift, payment of which was actually made by the partnership within its taxable year ending within or with the partner's taxable year. This item shall be accounted for separately by the partners as provided in section 702 (a) (4). See also paragraph (b) of § 1.702–1.

(v) The net operating loss deduction provided in section 172. See § 1.702–2.

(vi) The additional itemized deductions for individuals provided in part VII, subchapter B, chapter 1 of the Code, as follows: expenses for production of income (section 212); medical, dental, etc., expenses (section 213); expenses for care of certain dependents (section 214); alimony, etc., payments (section 215); and amounts representing taxes and interest paid to cooperative housing corporation (section 216). However, see paragraph (a)(8) of § 1.702–1.

(vii) The deduction for capital gains provided by section 1202 and the deduction for capital loss carryover provided by section 1212.

(b) *Elections of the partnership*—(1) *General rule.* Any elections (other than those described in subparagraph (2) of this paragraph) affecting the computation of income derived from a partnership shall be made by the partnership. For example, elections of methods of accounting, of computing depreciation, of treating soil and water conservation expenditures, and the option to deduct

as expenses intangible drilling and development costs, shall be made by the partnership and not by the partners separately. All partnership elections are applicable to all partners equally, but any election made by a partnership shall not apply to any partner's nonpartnership interests.

(2) *Exceptions.* (i) Each partner shall add his distributive share of taxes described in section 901 paid or accrued by the partnership to foreign countries or possessions of the United States (according to its method of treating such taxes) to any such taxes paid or accrued by him (according to his method of treating such taxes), and may elect to use the total amount either as a credit against tax or as a deduction from income.

(ii) Each partner shall add his distributive share of expenses described in section 615 or section 617 paid or accrued by the partnership to any such expenses paid or accrued by him and shall treat the total amount according to his method of treating such expenses, notwithstanding the treatment of the expenses by the partnership.

[T.D. 6500, 25 F.R. 11814, Nov. 26, 1960, as amended by T.D. 7192, 37 F.R. 12949, June 30, 1972]

§ 1.704 Statutory provisions; partner's distributive share.

SEC. 704. *Partner's distributive share*—(a) *Effect of partnership agreement.* A partner's distributive share of income, gain, loss, deduction, or credit shall, except as otherwise provided in this section, be determined by the partnership agreement.

(b) *Distributive share determined by income or loss ratio.* A partner's distributive share of any item of income, gain, loss, deduction, or credit shall be determined in accordance with his distributive share of taxable income or loss of the partnership, as described in section 702 (a) (9), for the taxable year, if—

(1) The partnership agreement does not provide as to the partner's distributive share of such item, or

(2) The principal purpose of any provision in the partnership agreement with respect to the partner's distributive share of such item is the avoidance or evasion of any tax imposed by this subtitle.

(c) *Contributed property*—(1) *General rule.* In determining a partner's distributive share of items described in section 702 (a), depreciation, depletion, or gain or loss with respect to property contributed to the partnership by a partner shall, except to the extent otherwise provided in paragraph (2) or (3), be allocated among the partners in the same manner as if such property had been purchased by the partnership.

(2) *Effect of partnership agreement.* If the partnership agreement so provides, depreciation, depletion, or gain or loss with respect to property contributed to the partnership by a partner shall, under regulations prescribed by the Secretary or his delegate, be shared among the partners so as to take account of the variation between the basis of the property to the partnership and its fair market value at the time of contribution.

(3) *Undivided interests.* If the partnership agreement does not provide otherwise, depreciation, depletion, or gain or loss with respect to undivided interests in property contributed to a partnership shall be determined as though such undivided interests had not been contributed to the partnership. This paragraph shall apply only if all the partners had undivided interests in such property prior to contribution and their interests in the capital and profits of the partnership correspond with such undivided interests.

(d) *Limitation on allowance of losses.* A partner's distributive share of partnership loss (including capital loss) shall be allowed only to the extent of the adjusted basis of such partner's interest in the partnership at the end of the partnership year in which such loss occurred. Any excess of such loss over such basis shall be allowed as a deduction at the end of the partnership year in which such excess is repaid to the partnership.

(e) *Family partnerships*—(1) *Recognition of interest created by purchase or gift.* A person shall be recognized as a partner for purposes of this subtitle if he owns a capital interest in a partnership in which capital is a material income-producing factor, whether or not such interest was derived by purchase or gift from any other person.

(2) *Distributive share of donee includible in gross income.* In the case of any partnership interest created by gift, the distributive share of the donee under the partnership agreement shall be includible in his gross income, except to the extent that such share is determined without allowance of reasonable compensation for services rendered to the partnership by the donor, and except to the extent that the portion of such share attributable to donated capital is proportionately greater than the share of the donor attributable to the donor's capital. The distributive share of a partner in the earnings of the partnership shall not be diminished because of absence due to military service.

(3) *Purchase of interest by member of family.* For purposes of this section, an interest purchased by one member of a family from another shall be considered to be created by gift from the seller, and the fair market value of the purchased interest shall be considered to be donated capital. The "family" of any individual shall include only his spouse, ancestors, and lineal descendants, and any trusts for the primary benefit of such persons.

(Government Requests to Charge, Dated 6/6/74).
Government Requests to Charge (Received by Defense 6/7/74).

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA V. THOMAS M. FAHEY	CRIMINAL NO. 73-CR-181

GOVERNMENT'S PROPOSED INSTRUCTIONS

Dated: Auburn, New York
June 6, 1974.

JAMES M. SULLIVAN, JR.
United States Attorney for the
Northern District of New York

By _____
Eugene Welch
Assistant U. S. Attorney

(Government Requests to Charge, Dated 6/6/74)
Government Requests to Charge (Received by Defense 6/7/74).

PROPOSED INSTRUCTION NO. 1

The gist of the offense charged in each Count of the indictment is a wilfull attempt on the part of the defendant Thomas Fahey to evade and defeat the tax imposed by the income tax law. To establish its case the government must prove beyond a reasonable doubt both of the following two elements, (1) that substantial income tax was due and owing from the defendant Thomas Fahey in addition to that declared in his 1966 and 1967 income tax returns, and (2) that the defendant Thomas Fahey wilfully attempted to evade and defeat such tax.

The phrase "wilfully attempts" as used in this law involves two things, (1) specific intent to evade and defeat the tax, and (2) some act done in furtheraace of such intent.

The phrase contemplates that the defendant Thomas Fahey knew that during the calendar years 1966, as to Count I, and 1967, as to Count II, he had an income which was taxable, and which he knew he was required by law to report and that he attempted to evade and defeat the tax thereon, or a portion thereof, by purposely reporting less than all of the taxable income.

There are various schemes, subterfuges, and devices, that may be resorted to in order to evade and defeat the tax. The one alleged in the indictment

against Mr. Fahey is that he filed a false and fraudulent return for each of the years 1966 and 1967, with intent to evade and defeat the tax liability; that is to day, with specific intent to defraud the government of the tax due from Thomas Fahey.

Section 7201, Internal Revenue Code of 1954;
Spies v. United States, 317 U.S. 492 (1943);
Lawn v. United States, 355 U.S. 339, 361 (1958);
Sansone v. United States, 380 U.S. 343, 351 (1965).

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NOT GIVEN _____

(Government Requests to Charge, Dated 6/6/74)
Government Requests to Charge (Received by Defense 6/7/74).

PROPOSED INSTRUCTION NO. 2

You are instructed that the wilfull attempt to evade and defeat income tax for one year is a separate offense from a wilfull attempt to evade and defeat the tax for a different year. In this case, therefore, Count I charges a separate offense as to 1966 and Count II charges a second separate offense as to 1967.

United States v. Sullivan, 98 F.2d 79 (2nd Cir. 1938)

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NOT GIVEN _____

(Government Requests to Charge, Dated 6/6/74)
Government Requests to Charge (Received by Defense 6/7/74).

PROPOSED INSTRUCTION NO. 3

(Subject to withdrawal on the basis of defense evidence)

If you find that the defendant Thomas Fahey did have some claim to carry-back losses which will eliminate his tax liability for the prosecution years, this does not constitute a defense to the crime of tax evasion.

Willingham v. United States, 289 F.2d 283 (5th Cir. 1961), cert. denied 368 U.S. 828, (1961).

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NOT GIVEN _____

(Government Requests to Charge, Dated 6/6/74)
Government Requests to Charge (Received by Defense 6/7/74).

PROPOSED INSTRUCTION NO. 4

If you find that a fraudulent return was filed by Thomas Fahey with intent to evade and defeat a part or all of the tax due and owing by him in 1966 and 1967, and that this was done wilfully, the crime is complete as soon as the filing takes place; that is, as to Count I, on or about April 15, 1968 and as to Count II, on or about April 15, 1968. You will recall that the two income tax returns involved here were filed on the same date.

Sansone v. United States, 380 U.S. 343 (1965);

Guzik v. United States, 54 F.2d 618 (7th Cir. 1931), cert. den., 285 U.S. 545;

United States v. Lustig (unreported decision, S.D. N.Y., No. C.121-463, June 20, 1946,) aff'd., 163 F.2d 85 (2nd Cir. 1947), cert. den., 332 U.S. 775; rehearing den., 332 U.S. 812.

GIVEN _____

GIVEN AS MODIFIED _____

NOT GIVEN _____.

(Government Requests to Charge, Dated 6/6/74)
Government Requests to Charge (Received by Defense 6/7/74).

PROPOSED INSTRUCTION NO. 5

The question of intent is a matter for you to decide, as jurors. Intent is a state of mind and it is not possible to look into a man's mind to see what went on. The only way you have of arriving at the intent of Thomas Fahey in this case, is for you to take into consideration all of the facts and circumstances shown by the evidence, including the exhibits, and determine from all such facts and circumstances whether it was the intent of Thomas Fahey at the time in question to defraud the government of the tax which he knew was due from him. Thus, direct proof of wilfulness or wrongful intent or knowledge is not necessary. Intent and knowledge may be inferred from acts and such inferences may arise from a combination of acts although such act standing by itself may seem unimportant. These are questions of fact for you to determine from all the circumstances.

In this regard, you may consider whether Thomas Fahey had an opportunity to correct his income tax returns and whether he was put on notice that such correction is necessary and that in spite of this he failed to take steps to file amended returns, as a circumstance in determining Mr. Fahey's intent.

In addition, you may consider the fact that Mr. Fahey filed his 1966 return a year late and that he

under-reported his taxable income by 69 per cent for two successive years.

Swallow v. United States, 307 F.2d 91 (10th Cir. 1962), cert. den., 371 U.S. 950, rehearing den., 372 U.S. 925;

Gaunt v. United States, 184 F.2d 284 (1st Cir. 1950), cert. den., 340 U.S. 917, rehearing den., 340 U.S. 939;

Paschen v. United States, 70 F.2d 491 (7th Cir. 1934);

Battjes v. United States, 172 F.2d 1 (6th Cir. 1949);

Hill v. United States, 363 F.2d 176 (5th Cir. 1966);

United States v. O'Connor, 433 F.2d 752 (1st Cir. 1970);

Holland v. United States, 348 U.S. 121, (1954).

GIVEN _____

GIVEN AS MODIFIED ____

NOT GIVEN _____

(Government Requests to Charge, Dated 6/6/74)
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PROPOSED INSTRUCTION NO. 6

In determining what the intent of Thomas Fahey was, you may take into consideration any evidence you find of the concealment of fact by the defendant. In this regard, you have heard testimony that in a routine audit in 1969 Mr. Fahey did not advise the auditor of this additional income from the partnership. Indeed, you may find that he was concealing facts by not disclosing this income in his 1966 and 1967 individual income tax returns. You may find that Mr. Fahey's failure to claim the $1,595.00 withheld from his partnership salary during 1966 was concealment by Mr. Fahey of the unreported income in 1966. If you find that these things were concealment, you may consider them as to the defendant Fahey's intent.

Spies v. United States, 317 U.S. 492 (1943);

United States v. Manton, 107 F.2d 834 (2nd Cir. 1938), cert. den., 309 U.S. 664;

Gariepy v. United States, 220 F.2d 252 (6th Cir. 1955), cert. den., 350 U.S. 825.

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GIVEN AS MODIFIED ____

NOT GIVEN _____

(Government Requests to Charge, Dated 6/6/74)
Government Requests to Charge (Received by Defense 6/7/74).

PROPOSED INSTRUCTION NO. 7

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If you find that the defendant, Thomas Fahey, signed the U. S. Partnership Returns for the partnership as well as his own income tax returns for the years in question, if you find that Thomas Fahey signed these returns under a declaration that he had examined the returns, and to the best of his knowledge and belief they were true, correct, and complete, you may consider that, as a circumstance in determining whether he had knowledge of the contents of those returns.

The fact that an individual's name is signed on a filed return shall be prima facie evidence for all purposes that the return was actually signed by him.

Paschen v. United States, 70 F.2d 491 (7th Cir. 1934); 26 U.S.C. §6072(b).

GIVEN:_____

GIVEN AS MODIFIED___

NOT GIVEN_____

(Government Requests to Charge, Dated 6/6/74)
Government Requests to Charge (Received by Defense 6/7/74).

PROPOSED INSTRUCTION NO. 8

Lack of intent may be proven by evidence showing that the defendant did not report the income in question on the advice of counsel. In this regard, you have heard some testimony concerning transmittal letters from the accountants to Mr. Fahey.

If you find that this was in fact the advice of Mr. Fahey's counsel in regard to his own individual income tax return, then you may consider this in determining Mr. Fahey's intent. But this is not a defense unless you find first that the defendant Thomas Fahey made a full disclosure of all the facts to his accountant, if you find that Ernst & Ernst were Mr. Fahey's accountants.

And, in addition, to consider this as a defense you must be satisfied that Thomas Fahey acted in good faith on the advice of this accountant and acted on all the advice given to him by the accountant.

United States v. McCormick, 67 F.2d 867 (2nd Cir. 1933), cert. denied 291 U.S. 662.

GIVEN _____

GIVEN AS MODIFIED ____

NOT GIVEN _____

(Government Requests to Charge, Dated 6/6/74)
Government Requests to Charge (Received by Defense 6/7/74).

PROPOSED INSTRUCTION NO. 9

The law requires that a partnership, which is a separate entity combined or made up of individuals, must make or file an income tax return for each taxable year establishing what items of income were generated by the partnership for each one of the partners involved.

In addition, the law requires that the individual partners file income tax returns showing thereon the income they themselves individually received from the partnership even though such income might be reported on the partnership return.

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26 U.S.C.§§6031, 6063, 6065(a);
Treasury Regulations 26 C.F.R. §1.6031-1(a).

GIVEN_____
GIVEN AS MODIFIED_____
NOT GIVEN_____

(Government Requests to Charge, Dated 6/6/74)
Government Requests to Charge (Received by Defense 6/7/74).

PROPOSED INSTRUCTION NO. 10

There have been admitted in evidence certain exhibits variously referred to as schedules or summaries, specifically, Government's Exhibit ____. Strictly speaking, these exhibits are not actual evidence, but they were admitted as summaries of other evidence in the case and they are admitted only for your assitance and convenience in considering the other evidence which they purport to summarize. Exhibits of this nature are permitted where they are based upon voluminous books, records and documents already in evidence, in order to assist you in determining the ultimate facts or results shown by such books, records and documents. But you are reminded that it is the books, records and documents which are the evidence, and the summaries are admitted only to assist you in considering that evidence. For that purpose, you are entitled to consider them.

Lloyd v. United States, 226 F.2d 9, 16-17 (5th Cir. 1955);
United States v. Bateman (unreported decision, W.D. Wash., Cr. No. 16169, February 17, 1953), aff'd., 212 F.2d 61 (9th Cir. 1954);
Epstein v. United States, 246 F.2d 563, 570 (6th Cir. 1957), cert. den., 355 U.S. 868.

GIVEN _____
GIVEN AS MODIFIED _____
NOT GIVEN _____

(Government Requests to Charge, Dated 6/6/74)
Government Requests to Charge (Received by Defense 6/7/74).

PROPOSED INSTRUCTION NO. 11

It is not necessary that the government prove an evasion of all the tax charged. It is sufficient if any substantial portion of a tax was attempted to be defeated and evaded as charged in that count.

United States v. Johnson, 319 U.S. 503 (1943), rehearing den., 320 U.S. 808.

GIVEN _____

GIVEN AS MODIFIED ____

NOT GIVEN _____

(Government Requests to Charge, Dated 6/6/74)
Government Requests to Charge (Received by Defense 6/7/74).

PROPOSED INSTRUCTION NO. 12

I charge you, as a matter of law, that the salary paid by the partnership to Mr. Fahey, if you find it was a salary, is required to be reported as a part of a total income on the U. S. Individual Income Tax Return.

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26 U. S. C. §61

GIVEN_____

GIVEN AS MODIFIED_____

NOT GIVEN_____